Statement of ICI Global
Hearing on "Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation"
Subcommittee on Capital Markets and Government Sponsored Enterprises
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives

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ICI Global ("ICIG") is pleased to provide this written statement in connection with the hearing on Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act – commonly known as the "Volcker Rule." Organized in October 2011, ICIG is a global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICIG seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICIG manage total assets in excess of US $1 trillion. They engage in a global fund business, interacting with regulators, investors and market participants around the world, and they therefore have a strong interest in the effects of the proposed implementing regulations ("Proposal")[1] on global funds, their managers, and investors, and on the markets in which such funds invest.

For the reasons set forth below, ICIG submits that the Proposal neither implements in a reasonable manner Congress' intent in enacting the Volcker Rule, nor gives effect to the limitations in the Volcker Rule that Congress specified. If adopted as drafted, the Proposal would impede the organization, sponsorship and normal activities of non-U.S. retail funds and harm certain financial markets, market participants, and financial instruments.

I. Introduction

The Volcker Rule and the Proposal seek to limit perceived risks associated with activities of banks and their affiliates related to proprietary trading and investments in, and sponsorship of, hedge funds, private equity funds and other similar funds (referred to as "covered funds"). The prohibitions apply to banking entities, which are broadly defined to include in effect virtually all non-U.S. banks of international dimension. For the restrictions related to covered funds, the Proposal is drafted so broadly that it includes as a covered fund essentially all non-U.S. funds, including those that are similar to tightly regulated U.S. mutual funds. The rule as adopted by Congress was not directed at

[1] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (November 7, 2011) available at http://www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf.

publicly offered, substantively regulated funds like U.S. mutual funds[2] or their non-U.S. corollaries ("non-U.S. retail funds").[3] Therefore, the Proposal should not expansively sweep these non-U.S. retail funds within the meaning of covered funds. Further, although there are exemptions to the Volcker Rule's restrictions for activities outside the United States, the Proposal implements those exemptions in a manner that is exceedingly complex, and that in practice likely will be so difficult to use as to render them unworkable.

As a consequence, the Proposal, if adopted, would unnecessarily disrupt and harm the activities of non-U.S. retail funds, including those affiliated with U.S. financial institutions, as well as non-U.S. financial markets in which U.S. investors, including mutual funds, participate. If non-U.S. retail funds are not accorded the same treatment as U.S. mutual funds, U.S. financial institutions that offer global fund products will be substantially disadvantaged when competing globally in the non-U.S. retail fund business – an altogether inappropriate and unintended result, as these funds are not "hedge funds" and do not pose the risks intended to be addressed by the Volcker Rule.

We outline below changes that we believe must be made to regulations implementing the Volcker Rule as proposed, so that they do not impede the organization, sponsorship and normal activities of non-U.S. retail funds and harm certain financial markets, market participants, and financial instruments. The issues highlighted below will be discussed in greater detail in ICIG's comment letter on the Proposal, which we plan to file by the February 13 deadline.

II. Non-U.S. retail funds must be treated like U.S. mutual funds and excluded from the definition of covered fund.

Like U.S. mutual funds, which are not intended to be covered by the Volcker Rule, non-U.S. retail funds are designed for retail investors and are subject to home country oversight and regulation of a nature consistent with a fund that is offered and sold to the general public, including regulation limiting the ways in which such a fund may invest. Under the Volcker Rule, a banking entity is prohibited from having an ownership interest in, or acting as sponsor to, a hedge fund, private equity fund, or "similar fund" as the regulators determine by rule.[4] The Proposal, however, greatly expands the reach of the Volcker Rule by broadening the definition of "covered fund" potentially *to encompass*

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[2] U.S. mutual funds are investment companies registered under the Investment Company Act of 1940 ("1940 Act") and therefore do not rely on an exemption from the definition of investment company in Section 3(c)(1) or 3(c)(7) of the 1940 Act.

[3] For purposes of this document, we include in the term "non-U.S. retail fund" any fund that has its principal office and place of business outside the United States, makes a public offering of its securities in a country outside the United States, and is substantively regulated as a public investment company under the laws of the country other than the United States.

[4] The Volcker Rule gives the regulators the authority to include funds that are "similar" to funds that would be investment companies under the 1940 Act but for Section 3(c)(1) or 3(c)(7) of that Act. *See* 12 U.S.C. § 1851(h)(2). These funds, however, are excluded from substantive regulation and required to be offered to a tightly circumscribed number or type of investors.

every securities or futures related investment fund in the world, other than U.S. mutual funds.[5] This effectively treats all non-U.S. retail funds as the equivalent of hedge funds and private equity funds, rather than like U.S. mutual funds to which they are far more analogous. Treating all non-U.S. retail funds as equivalent to a hedge fund or private equity fund is simply inaccurate and contrary to Congressional intent.

Further, failing to treat non-U.S. retail funds similarly to U.S. mutual funds may be inconsistent with U.S. "national treatment" trade commitments. By treating non-U.S. retail funds like hedge funds, non-U.S. banking entities will face added costs and complexities in their domestic, non-U.S. retail fund businesses as a result of accessing the U.S. banking market, while bank affiliated U.S. mutual fund businesses will not suffer the same negative impacts. These impacts would be substantial for many funds. For example, many banks in Europe and Asia will be subject to the Volcker Rule.[6] These banks are actively involved in the management and distribution of retail funds. These fund management groups would be forced to comply with the foreign fund exception or the sponsored fund exception (discussed below) in order to run their non-U.S. retail fund business, requiring dramatic changes to the operation and management of such funds, including their launch and distribution.

Providing an express exclusion for non-U.S. retail funds from the definition of "covered fund" would avoid this result. The definition of "covered fund" should be revised to exclude any fund that has its principal office and place of business outside the United States, makes a public offering of its securities in a country outside the United States, and is regulated as a public investment company under the laws of a country other than the United States.

III. Regulation S should be used to define who is a U.S. person and therefore what constitutes the non-U.S. securities markets for purposes of defining the parameters of the exemption for proprietary trading by non-U.S. banks occurring solely outside of the United States.

The Volcker Rule contains an exemption to the general prohibition on proprietary trading for non-U.S. banks that engage in that activity solely outside of the United States (the "foreign trading exemption"). Due to the complexities and burdens of relying upon the market making and other possible exemptions to the Volcker Rule's general prohibition on proprietary trading, we believe that many non-U.S. banks will seek to rely on this exemption.[7]

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[5] *See* § ___.10(b)(1). As discussed in a statement filed today with this Subcommittee by the Investment Company Institute, the Proposal's broad expansion of "covered fund" could also sweep in a number of U.S. mutual funds – a result not intended by Congress.

[6] Under the Volcker Rule and the Proposal, any foreign bank that maintains a branch in the United States is included in the definition of banking entity.

[7] The statement filed today by the Investment Company Institute includes a discussion of the difficulties complying with the Proposal's market maker exemption, and the resulting likely negative impact on the structure and operation of the markets.

The Proposal defines those circumstances in which proprietary trading will be considered to have occurred outside the United States. A key condition here is that no party to a trade that is made in reliance on this exemption may be a "resident of the United States." The Proposal, however, with no explanation or justification, defines "resident of the United States" for purposes of this exemption differently and much more broadly than Regulation S under the Securities Act of 1933, as amended ("1933 Act"). That regulation defines the term "U.S. person"[8] for purposes of determining whether an offer or sale takes place in the U.S. securities markets and is consequently subject to the U.S. securities laws. Regulation S is well understood and, for more than 20 years, has been the global standard for defining the line between the U.S. securities markets and the non-U.S. securities markets.

The Proposal's interpretation leads to troubling results. If the Proposal is adopted in its current form, confusion inevitably will result, as there will be two different definitions governing when an entity will be subject to our jurisdiction as a U.S. person. This will have significant negative consequences for market participants and liquidity. For example, in contrast to the approach under Regulation S, the Proposal would treat a non-U.S. retail fund with a U.S. investment adviser as a U.S. person. Therefore, such fund would not be able to trade with a non-U.S. banking entity relying on the foreign trading exemption, leading to likely market disruption and substantially less liquidity in those markets.[9]

The Proposal is inconsistent with the presumed Congressional intent to avoid extraterritorial application to activities outside the United States. Instead, Regulation S should be used to define who is a U.S. person, and therefore what constitutes the non-U.S. securities markets for purposes of the foreign trading exemption.

IV. Non-U.S. government obligations should be exempted from the proprietary trading restrictions.

While the Proposal exempts U.S. government obligations from the Volcker Rule's proprietary trading prohibitions, it does not similarly provide an exemption for non-U.S. government obligations. As a result, substantial and negative impacts will occur in the trading of obligations of foreign governments and international and multinational development banks if the Proposal is not revised. Non-U.S. retail funds invest in non-U.S. government obligations and harm to the trading and liquidity of these instruments directly impacts investors in these funds. Exempting non-U.S. government securities is consistent with limiting the extraterritorial reach of the Volcker Rule and would not undermine the purposes of the Volcker Rule.[10]

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[8] *See* 17 C.F.R. § 230.902(k).

[9] The Proposal also surprisingly treats the International Monetary Fund and the International Bank for Reconstruction and Development (the "World Bank") as U.S. residents under the proposed rules, although these organizations are not U.S. persons for purposes of Regulation S.

[10] Regulatory authorities in Japan and Canada have similarly advocated for an exemption from the proprietary trading restrictions for non-U.S. government obligations. *See* Letter from Financial Services Agency, Government of Japan, and

V. The exemption for covered fund activities solely outside the United States ("foreign fund exemption") is so narrow that it is essentially unusable.

Under the Volcker Rule, covered fund activities occurring solely outside the United States are permitted to a banking entity when that entity is not directly or indirectly controlled by a banking entity organized under U.S. law. The Proposal so narrowly interprets this exemption, however, that it would be practically unusable. This interpretation fails to fulfill presumed Congressional intent to avoid extraterritorial application to activities outside the United States.

In particular, the foreign fund exemption, like the foreign trading exemption, without explanation or justification, relies on a different and broader definition of "U.S. resident" than the widely accepted Regulation S definition. Unless the definition is changed to mirror Regulation S, non-U.S. retail funds will be required to go through the extraordinary expense of revamping their entire offering and compliance processes to accommodate an additional definition. There is a well established regime that is currently in place and used by issuers to guard against offers and sales to U.S. persons (i.e., to ensure that the transaction is "offshore").

In addition, the foreign fund exemption, if adopted as proposed, would disallow incidental U.S. contacts, which is wholly inconsistent with current market practice and investor realities, particularly with the global nature of fund businesses. As a result, the foreign fund exemption is too narrow to be useable. Such a result would mean non-U.S. retail funds, even though they are offshore, would have to comply with the sponsored fund exemption (described below) or be subject to the full Volcker Rule restrictions and prohibitions applicable to hedge funds.

VI. Non-U.S. retail funds should be excluded from the definition of "banking entity."

Non-U.S. retail funds do not raise issues the Volcker Rule was designed to prevent. Such funds should be excluded from the definition of banking entity. Otherwise, banking entity status would subject such funds themselves to the Volcker rule, e.g., the prohibitions on proprietary trading – a result at odds with the nature of their business as collective investment vehicles. Providing an express exclusion for non-U.S. retail funds from the definition of "banking entity" would avoid this result without thwarting in any way the policy goals of the Volcker Rule.

The Proposal does provide an exemption from the definition of "banking entity" to any covered fund that is organized, offered and held by a banking entity as a customer fund (the "sponsored fund exemption"). As the Proposal is drafted, however, other types of covered funds that are affiliates of a banking entity would constitute banking entities, including non-U.S. retail funds relying on the foreign fund exemption. Such funds similarly should be excluded from the definition of banking entity.

Bank of Japan, to Mr. John G. Walsh, Acting Comptroller of the Currency, Office of the Comptroller of the Currency, and others, dated December 28, 2011 and Letter from Julie Dickson, Superintendent, Office of the Superintendent of Financial Institutions Canada, to Department of the Treasury, Office of the Comptroller of the Currency, and others, dated December 28, 2011.

VII. The "Super 23A" limitations should not apply to covered funds managed by non-U.S. banking entities that satisfy the foreign fund exemption.

The Volcker Rule prohibits a banking entity that serves as an investment manager or sponsor of a covered fund from entering into transactions with that fund if the transaction would constitute a "covered transaction" under Section 23A of the Federal Reserve Act ("Super 23A limitations"). There is no exemption under the Proposal for covered funds that rely on the foreign fund exemption. Applying the Super 23A limitations in such a case frustrates the intent of Congress in the foreign fund exemption and is an expansive application of U.S. prudential standards to entities outside of the jurisdiction of the United States. The 23A limitations should not be apply to covered funds and banking entities relying on the foreign fund exemption.

VIII. The exemptions for proprietary trading by insurance companies should be clarified to extend to investments by insurance companies in covered funds.

The Proposal, if adopted, could have a disproportionate and negative effect on non-U.S. retail funds as opposed to U.S. mutual funds with respect to investments in those funds by insurance companies that are covered banking entities. The Proposal provides that "[t]he prohibition on proprietary trading contained in § ___.3(a) does not apply to the purchase or sale of a covered financial position by an insurance company or an affiliate of an insurance company" if certain other requirements are met and the purchases or sales are solely for the general account of the insurance company. In addition, the Proposal contains an exemption from the proprietary trading restrictions for the "purchase or sale of a covered financial position by a covered banking entity on behalf of its customers" if "[t]he covered banking entity is an insurance company that purchases or sells a covered financial position for a separate account," and other requirements are met. The Proposal, however, includes no comparable exemptions for insurance companies with regard to the covered fund restrictions, suggesting, oddly, that insurance companies, either through their general accounts or separate accounts, may not invest in covered funds, but may engage in proprietary trading.

Such a result disproportionately would affect non-U.S. retail funds (which are treated as covered funds under the Proposal) as compared to U.S. mutual funds. Under this scenario, investments by insurance companies or their separate accounts in U.S. mutual funds would not be prohibited, but the same types of investments by insurance companies or their separate accounts in non-U.S. retail funds would be subject to the restrictions of the Volcker Rule if the Proposal were adopted. There is no policy reason, however, to be more restrictive toward the activities of non-U.S. retail funds than to their U.S. counterparts. The statutory language supports this conclusion as there is no suggestion that the permitted activity exemption for insurance companies applies only to the proprietary trading restrictions. Further, the agencies recognize this fact in the Proposal, noting that "section 13(d)(1) of the [BHCA] expressly includes exemptions from these prohibitions [referring to the proprietary trading and covered fund activity prohibitions] for certain permitted activities," including trading for the general account of insurance companies.[11] The Proposal, however, provides

[11] Proposal, 76 Fed. Reg. at 68,848.

no explanation for why the permitted activity exemptions should be limited to the proprietary trading prohibitions.

IX. There are other significant and adverse consequences impacting non-U.S. retail funds as well as other areas requiring clarification or revisions.

In addition to the issues specifically addressed above, the Proposal raises other substantial issues and concerns with respect to non-U.S. retail funds that require clarification including, but not limited to, questions related to non-U.S. retail fund distribution arrangements with banking entities, custody and depositary services by banking entities for non-U.S. retail funds, and the activities of banking entities that are authorized participants in connection with non-U.S. retail ETFs. These topics will be discussed more fully in ICIG's comment letter on the Proposal.