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ICI VIEWPOINTS

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Proposal to Implement Volcker Rule Raises Significant Issues for Regulated Funds Globally

By Dan Waters

Congress enacted the provision of the Dodd-Frank Reform Act known as the Volcker Rule to restrict banks from sponsoring and investing in hedge funds (so-called covered funds) and using their own resources to trade for purposes unrelated to serving clients—something known as "proprietary trading." It seems clear that Congress did not craft the Volcker Rule to target publicly offered, substantively regulated funds like U.S. mutual funds and non-U.S. retail funds. However, the way in which regulators have proposed to implement the Volcker Rule raises significant issues for non-U.S. retail funds. In response to this proposal, ICI Global has submitted a detailed comment letter.

The two examples from the ICI Global comment letter below demonstrate the impact of the rule on non-U.S. retail funds, from the perspective of funds as funds and as investors participating in the global capital markets.

Fund perspective

The proposal expands the category of funds captured by the Volcker Rule, deeming countless investment funds around the world to be "covered funds," including non-U.S. retail funds. This would inappropriately and unduly impede the organization, sponsorship, and normal activities of non-U.S. retail funds. This is contrary to Congress's intent to focus on hedge funds and private equity funds, not registered funds, and to limit the extraterritorial reach of the statute.

- To address this problem, the proposal should be revised to treat non-U.S. retail funds like U.S. registered funds and expressly exclude them from the definition of "covered fund." In addition, both U.S. registered funds and non-U.S. retail funds should be excluded from the definition of "banking entity."

Market participant perspective

Because the proposal's foreign trading exemption significantly differs from the Securities and Exchange Commission's (SEC's) long-standing and globally understood rules for delineating between U.S. and offshore securities transactions—known as Regulation S—the proposal would disrupt the global securities markets, including trading with a "resident of the United States." The proposal raises genuine concerns, as it will impact portfolio management of non-U.S. retail funds and the availability of liquid securities, and increase trading costs. We are concerned that a possible result is smaller and/or fragmented markets with less liquidity for many securities that are important to global investors.

- The final rule should use the existing Regulation S regime for the foreign trading exemption to reasonably limit the extraterritorial reach of the Volcker Rule—this is more consistent with Congress's intent and will minimize disruption in the non-U.S. financial markets.

Those are just two examples of our deep concerns with the Volcker Rule's impact on non-U.S. funds. Please see the full letter for a detailed description of the issues identified.

- ICIG also submitted a statement for a joint House subcommittee hearing January 18 on the impact of the Volcker Rule.

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