STATEMENT OF

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PRESIDENT AND CEO
INVESTMENT COMPANY INSTITUTE

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ON

“EXAMINING THE IMPACT OF THE VOLCKER RULE ON MARKETS, BUSINESSES, INVESTORS AND JOB CREATION, PART II”

DECEMBER 13, 2012
EXECUTIVE SUMMARY

- Congress enacted the Volcker Rule to restrict banks from using their own resources to trade for purposes unrelated to serving clients and to address perceived conflicts of interest in certain bank transactions. The Volcker Rule was not directed at registered funds. Unfortunately, the regulatory proposal to implement the Volcker Rule (“Proposed Rule”) nonetheless raises a number of serious concerns for U.S. mutual funds and other types of registered investment companies (“registered funds”).

- Chief among our concerns is the fact that the Proposed Rule could treat many registered funds as hedge funds—a result that contradicts the plain language that Congress passed. Providing an express exclusion for registered funds would avoid this result.

- Similarly, without an express exclusion, it is possible that some registered funds could be treated as “banking entities” and subject to all of the prohibitions and restrictions in the Volcker Rule. It is clear that Congress did not intend such a result, and providing this exclusion for registered funds would in no way thwart the policy goals of the Volcker Rule.

- ICI supports the overall goals of the Volcker Rule’s proprietary trading prohibition, particularly the need to address systemic risk concerns surrounding truly speculative proprietary trading. We do not believe, however, that the Proposed Rule’s proprietary trading restrictions, as currently drafted, will achieve these goals. Instead, they may adversely impact the financial markets and the ability of registered funds and other investors to participate in the markets.

- We are particularly concerned that the Proposed Rule would decrease liquidity, especially for those markets that rely most on banking entities to act as market makers, such as the fixed income and derivatives markets and the less liquid portions of the equities markets. A reduction of liquidity would have serious implications for registered funds, ultimately leading to the potential for higher costs for fund shareholders.

- The proprietary trading provisions of the Proposed Rule call into question whether banking entities could continue to serve as Authorized Participants (“APs”) and market makers for exchange-traded funds (“ETFs”), an increasingly popular form of registered fund that is structured to permit investors to buy and sell shares at market prices throughout the trading day. AP transactions and related ETF market making activity are critical to maintaining efficient pricing in the ETF marketplace and protecting ETF investors. We recommend making it clear that banking entities can continue to fulfill these important roles.

- The Proposed Rule raises similar and additional concerns for the foreign counterparts to registered funds, i.e., funds that are publicly offered and substantively regulated outside of the United States (“non-U.S. retail funds”). Without substantial changes, the Proposed Rule would unduly impede the ability of both U.S. and non-U.S. entities to organize, sponsor, and operate non-U.S. retail
funds and harm certain financial markets, market participants, and financial instruments. Providing an exclusion for non-U.S. retail funds would ensure that the Volcker Rule is not applied more restrictively outside the United States than within, and is consistent with Congressional intent to limit the extraterritorial impact of these requirements.
I. INTRODUCTION

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute ("ICI"), the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of registered funds, their shareholders, directors, and advisers. As of December 2012, members of ICI manage total assets of $13.8 trillion.

I appreciate the opportunity to provide ICI’s perspective on the impact of Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act—commonly known as the “Volcker Rule”—on markets, businesses, investors, and job creation. The registered fund industry has a unique perspective, because our funds are both issuers of securities and investors in domestic and international financial markets.

As with the Dodd-Frank Act more broadly, ICI has closely followed developments related to the implementation of the Volcker Rule, actively engaging with policymakers during the implementation process. Our efforts are focused on ensuring that the implementing regulations do not have harmful or unintended consequences for registered funds and their shareholders—or for the financial markets or the broader economy—and that any final regulations strike the right balance between costs and benefits.

Congress enacted the Volcker Rule to restrict banks from using their own resources to trade for purposes unrelated to serving clients and to address perceived conflicts of interest in certain bank transactions. As several members of Congress have expressly indicated, the Volcker Rule was not directed at registered funds. Unfortunately, the regulatory proposal to implement the Volcker Rule ("Proposed Rule") nonetheless raises a number of serious concerns for the U.S. registered fund

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1 For ease of reference, this testimony refers to all types of U.S. registered investment companies—including mutual funds, closed-end funds, ETFs, and UITs—as “registered funds,” unless the context requires otherwise.


3 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), issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System ("Federal Reserve"), Federal Deposit Insurance Corporation ("FDIC"), and Securities and Exchange Commission ("SEC"). The Commodity Futures Trading Commission ("CFTC") was not a party to the Proposed Rule; instead, it issued a separate yet substantively similar proposal to implement the Volcker Rule. See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With,
industry. ICI believes that the Agencies involved have the authority to address most of these concerns through the regulatory process.

If adopted in its original form, the Proposed Rule would reach much farther than it seems Congress intended. For example, the Proposed Rule could treat many registered funds as hedge funds—a result that contradicts the plain language that Congress passed. The Proposed Rule also could restrict banks from acting as market makers buying and selling securities—despite the fact that Congress specifically designated “market making-related activity” as a “permitted activity” for banks under the Volcker Rule. If banks cannot provide these services, particularly in the fixed income and derivatives markets and the less liquid portions of the equity markets, registered funds and other investors likely would face higher transaction costs and diminished returns. The Proposed Rule also could greatly impair the U.S. financial markets by imposing stringent restrictions that go well beyond what is necessary to effectuate Congress’ intent in enacting the Volcker Rule, potentially hurting our broader economy and impacting job creation and investments in U.S. businesses overall. Finally, the Proposed Rule, as issued, could limit investment opportunities for registered funds and their shareholders. ICI’s comment letter on the Proposed Rule described these and other concerns in detail.4

The Proposed Rule raises similar and additional concerns for funds that closely resemble registered funds but are publicly offered and substantively regulated outside of the United States (“non-U.S. retail funds”). Without substantial changes, the Proposed Rule would unduly impede the ability of both U.S. and non-U.S. entities to organize, sponsor, and operate non-U.S. retail funds and harm certain financial markets, market participants, and financial instruments. Our global affiliate, ICI Global (“ICIG”), filed a detailed comment letter addressing the concerns of non-U.S. retail funds.5

Hedge Funds and Covered Funds, 77 Fed. Reg. 8332 (February 14, 2012). Below, this testimony refers to the foregoing regulators collectively as the “Agencies.”


5 See Letter from Dan Waters, Managing Director, ICI Global (“ICIG”), to Ms. Elizabeth M. Murphy, Secretary, SEC, et al., dated February 13, 2012, available at http://www.ici.org/pdf/12_icig_volcker.pdf. ICIG is the 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.
My testimony highlights important ways in which the Proposed Rule could negatively impact U.S. registered funds and non-U.S. retail funds. After the close of the comment period for the Proposed Rule, Chairman Bachus invited interested parties to submit legislative recommendations for ways to make the Volcker Rule less burdensome. A copy of the proposed legislative changes ICI submitted to Chairman Bachus (revised as of December 12, 2012) is attached as an Appendix to this testimony and several of our recommendations are mentioned herein.

Before turning to those issues, however, I wish to note that some press reports have mentioned the possibility that the individual regulatory agencies charged with implementing the Volcker Rule might adopt final regulations that differ from each other in substance. Such a result, it seems to me, would violate the requirement in Section 619 that the Agencies coordinate their rulemaking so as to assure, to the extent possible, that such regulations are comparable and provide for consistent application and implementation of this section to avoid providing advantages or imposing disadvantages to the companies affected . . . .

Such a result, moreover, would be particularly unworkable for firms that comprise multiple entities with different primary regulators. We accordingly urge the Committee to do all it can to ensure that any final rules will be consistent across all of the Agencies. Given the significant changes we believe are necessary to address our concerns and those of other commenters, ICI recommended in its comment letter, and still strongly urges, that the Agencies issue a revised proposal for comment before adopting any final rule.

II. ORGANIZATION, SPONSORSHIP AND NORMAL ACTIVITIES OF REGISTERED FUNDS

A. The Volcker Rule Should Not Treat U.S. Registered Funds or Their Non-U.S. Counterparts as Hedge Funds or Private Equity Funds

The Dodd-Frank Act prohibits a banking entity from having an ownership interest in, or acting as sponsor to, a hedge fund or private equity fund. The statute defines “hedge fund” and “private equity fund” as “any issuer that would be an investment company, as defined in the Investment Company Act, but for Section 3(c)(1) or 3(c)(7) of that Act,” or “such similar funds” as the Agencies may determine by rule—collectively defined in the Proposed Rule as “covered funds.”

It is clear that Congress did not intend for the Volcker Rule to extend to U.S. registered funds. The statute applies to two types of investment funds that are explicitly excluded from regulation under the Investment Company Act and, as determined by the Agencies, to funds that are “similar” to those excluded funds. Moreover, a registered fund is not remotely “similar” to a hedge fund or private equity fund. Registered funds are subject to a comprehensive regulatory regime under the Investment Company Act that focuses first and foremost on investor protection, and such funds are designed to be publicly offered and sold to all investors. Hedge funds and private equity funds, on the other hand, are identified in Section 619 by the two sections of the Investment Company Act that keep those funds
outside that Act’s regulatory protections. In addition, shares of a hedge fund or private equity fund cannot be sold publicly but rather only to a limited number of investors (in the case of a Section 3(c)(1) fund) or to a carefully defined set of sophisticated investors (in the case of a Section 3(c)(7) fund).

The legislative history of the Dodd-Frank Act reflects the concern of the primary authors of the statute and other members of Congress that the Section 619 definition of hedge fund and private equity fund not be interpreted too broadly. Indeed, members engaged in colloquies to clarify that references to the Section 3(c)(1) and Section 3(c)(7) exclusions under the Investment Company Act should not be read broadly to sweep in subsidiaries, joint ventures, venture capital funds and other structures that rely on those exclusions but “will not cause the harms at which the Volcker rule is directed.”6 It would pervert the intended scope of the Volcker Rule were the Agencies to take too broad a view of what constitutes a “similar fund.”

Unfortunately, the Proposed Rule would expand the reach of the Volcker Rule far beyond what Congress intended, even to the extent of sweeping in a number of registered funds. This is because the Proposed Rule includes within its definition of “covered fund” any investment vehicle that is considered a “commodity pool” under Section 1a(10) of the Commodity Exchange Act. Section 1a(10) broadly defines “commodity pool” to include “any investment trust, syndicate or similar form of enterprise operated for the purpose of trading in commodity interests,” including, among other things, any security futures product or swap. A registered fund might use security or commodity futures, swaps, or other commodity interests in varying ways to manage its investment portfolio, including for reasons wholly unrelated to providing exposure to the commodity markets.7 The broad CEA definition of “commodity pool” thus could bring such a registered fund into the Volcker Rule.8 Providing an express exclusion for registered funds, either in the statute or the implementing regulations, would avoid this result.

Similarly, under the Proposed Rule as drafted, all non-U.S. retail funds (including ETFs) inappropriately are encompassed by the definition of “covered fund.” As with U.S. registered funds, there should be an express exclusion from the Volcker Rule for non-U.S. retail funds. Like U.S. registered funds, non-U.S. retail funds are regulated in their home jurisdictions. As a condition of their being offered to retail investors, these funds are regulated with respect, for example, to how they may invest and operate, the disclosure they must provide to their investors, the means by which they value


7 Uses of these instruments include, for example, hedging positions, equitizing cash that cannot be immediately invested in direct equity holdings (e.g., when the stock market has already closed for the day), managing cash positions more generally, adjusting portfolio duration (e.g., seeking to maintain a stated duration of seven years as a fund’s fixed income securities age or mature), managing bond positions in general (e.g., in anticipation of expected changes in monetary policy or the Treasury’s auction schedule), or managing the fund’s portfolio in accordance with the investment objective stated in the fund’s prospectus (e.g., an S&P 500 index fund that tracks the S&P 500 using a “sampling algorithm” that relies in part on S&P 500 or other futures).

8 As explained in our comment letter, the Agencies may not have contemplated that the CEA definition of “commodity pool” could reach many registered funds. See ICI Volcker Comment Letter, supra note 4, at 8.
their portfolio securities, their corporate governance, and their use of leverage. They are not managed or structured like hedge funds or private equity funds and so should not be treated as “similar funds” under the Volcker Rule. Providing an exclusion for non-U.S. retail funds would ensure that the Volcker Rule is not applied more restrictively outside the United States than within, a result wholly consistent with Congressional intent to limit the extraterritorial impact of these requirements.

B. The Definition of “Banking Entity” Expressly Should Exclude All U.S. Registered Funds and Their Non-U.S. Counterparts

The Volcker Rule’s prohibition on proprietary trading and its restrictions on activities involving hedge funds and private equity funds apply to “banking entities.”9 A registered fund would fall within the definition of “banking entity” if it were considered an affiliate or subsidiary of a banking entity (e.g., its investment adviser). In that event, the registered fund itself would be subject to all the prohibitions and restrictions in the Volcker Rule as implemented by the Proposed Rule.

There is no indication that Congress intended this result. It appears that the Agencies did not intend it either; the preamble to the Proposed Rule indicates that a registered fund generally would not be considered a subsidiary or affiliate of the banking entity that sponsors or advises it. Without an express exclusion, however, it remains possible that some registered funds nevertheless could be captured by the regulations as banking entities.

For example, it is common industry practice for an investment adviser/sponsor to provide the initial “seed” capital necessary to launch a new registered fund. During the period following the launch of a new fund, when the banking entity adviser/sponsor may own all or nearly all of the shares of the fund as a result of its investment of seed capital, the registered fund could be considered an affiliate (as defined in the Bank Holding Company Act (“BHCA”)) of the adviser/sponsor. If so, the fund would be captured by the proposed definition of “banking entity” and become subject to the Volcker Rule in its own right.10 This could have the effect of essentially barring banking entities from sponsoring the most highly regulated type of investment vehicle and, thereby, limiting investment options for investors. Further, it would, in effect, ban banking entities from engaging in an activity that is permitted under the BHCA and other federal banking laws and that was never intended to be affected

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9 The Proposed Rule generally defines “banking entity” to include: (1) an insured depository institution; (2) a company that controls an insured depository institution; (3) a company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978; and (4) subject to certain exceptions, an affiliate or subsidiary of any of the foregoing. “Affiliate” and “subsidiary” are defined by reference to the definitions of those terms in Section 2 of the Bank Holding Company Act.

10 A similar result could arise in the ETF context, as well as for other types of registered funds, including closed-end funds and unit investment trusts (“UIT’s”). In particular, there are instances in which a banking entity involved in the underwriting of a closed-end fund or UIT temporarily owns a controlling interest in that fund. We do not believe that Congress intended for the Volcker Rule to interfere with the organization or operation of any type of registered fund.
by the Volcker Rule.\textsuperscript{11} It also would put banking entity sponsors at a competitive disadvantage compared with their non-bank-affiliated peers, which have no limits on their ability to furnish seed capital.

For some ICI member firms, the banking entity that triggers application of the Volcker Rule is an insured depository institution that is small in relation to the overall firm and does not constitute part of the firm’s core line(s) of business. Ironically, the impracticality that results from applying the Proposed Rule could well cause these firms to discontinue their limited banking operations even though they do not engage in proprietary trading and may not sponsor or have ownership interests in any hedge funds or private equity funds.

Providing an express exclusion for all registered funds from the definition of “banking entity”—either in the implementing regulations or the statute—would address all of the concerns described above without thwarting in any way the policy goals of the Volcker Rule. Even during the post-launch period, when a banking entity investment adviser may own all or nearly all of a fund’s shares, the registered fund must be operated in accordance with the comprehensive regulatory regime administered by the SEC under the Investment Company Act and other federal securities laws. Notably in this context, registered funds are subject to oversight by an independent board of directors,\textsuperscript{12} strong conflict of interest protections through prohibitions on affiliated transactions,\textsuperscript{13} and strict restrictions on leverage.\textsuperscript{14}

To avoid the potential for serious and disruptive effects on their organization and operation, the definition of “banking entity” also should expressly exclude non-U.S. retail funds. The justifications for such an exclusion are largely the same as those outlined in Section II.A above with respect to the definition of “hedge fund” and “private equity fund.” In particular, the highly regulated nature of non-U.S. retail funds and the intent of Congress to limit the extraterritorial impact of the Volcker Rule provide strong support for excluding these funds from the definition of “banking entity.”

\textsuperscript{11} Under the BHCA, banking organizations generally may sponsor and “seed” registered funds so long as they (a) do not exercise managerial control over the portfolio companies of funds, and (b) reduce their ownership stake in sponsored funds to below 25 percent within one year (or seek Federal Reserve Board approval for an extension). 12 CFR 225.86(b)(3).

\textsuperscript{12} See, e.g., Section 10(a) of the Investment Company Act (requiring a mutual fund or closed-end fund to have a board of directors at least 40 percent of which must be independent directors. As of year-end 2010, independent directors made up three-quarters of boards in more than 90 percent of fund complexes. Independent Directors Council and Investment Company Institute, \textit{Overview of Fund Governance Practices, 1994–2010} (October 2011).

\textsuperscript{13} See Section 17(a) of the Investment Company Act; Section 23A of the Federal Reserve Act.

\textsuperscript{14} See, e.g., Section 18 of the Investment Company Act (restrictions applicable to mutual funds and closed-end funds).
C. The Volcker Rule Should Not Limit the Ability of Banking Entities to Serve as Authorized Participants and Market Makers for Registered Exchange-Traded Funds

The proprietary trading provisions of the Proposed Rule call into question whether banking entities could continue to serve as Authorized Participants (“APs”) and market makers for ETFs registered under the Investment Company Act, as well as non-U.S. retail ETFs. ETFs are similar to mutual funds (the most common type of registered fund) except that they list their shares on a securities exchange, thereby allowing retail and institutional investors to buy and sell shares throughout the trading day at market prices. Increasingly popular with investors, ETFs use a different process for offering their shares. APs alone transact in shares directly with ETFs, in large amounts (typically involving 50,000 to 100,000 ETF shares) based not on market prices but on the ETF’s daily net asset value. AP transactions with an ETF are a unique and controlled form of arbitrage trading that, in the view of the SEC, is a critical component of maintaining efficient pricing in the ETF marketplace and protecting ETF investors.

Some banking entities also may engage in traditional market making activities in ETFs. In this capacity, they may provide seed capital, as well as temporarily hold inventory of ETF shares and the underlying securities or their economic equivalent in order to help maintain efficient pricing in the ETF marketplace. Although these are market making activities that should be permitted by the Proposed Rule, we are concerned that they may not be deemed to be “designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.” We recommend making it clear, either in the implementing regulations or the statute, that banking entities can continue to fulfill these important roles.

III. IMPACT ON THE FINANCIAL MARKETS

Section 619 of the Dodd-Frank Act prohibits a banking entity from engaging in proprietary trading of securities, derivatives, and certain other financial instruments for its own account. Notwithstanding this broad prohibition, the statute provides exemptions for a banking entity to engage in certain “permitted activities.” Significantly, exemptions are provided for positions taken in connection with market making-related activities, risk-mitigating hedging activities, and trading in certain U.S. government securities.

ICI supports the overall goals of the Volcker Rule’s proprietary trading prohibition, particularly the need to address systemic risk concerns surrounding truly speculative proprietary trading. We do not believe, however, that the Proposed Rule’s proprietary trading restrictions, as currently drafted, will achieve these goals. Instead, they may adversely impact the financial markets and the ability of registered funds and other investors to participate in the markets.
A. Liquid and Efficient Markets are Important for Registered Funds

For registered funds, the availability of liquidity is a critical element of efficient markets. Banking entities are key participants in providing this liquidity, promoting the orderly functioning of the markets as well as the commitment of capital when needed by investors to facilitate trading.

Liquidity is particularly important in the everyday operations of mutual funds, which typically offer their shares on a continuing basis and are required by the Investment Company Act to issue “redeemable securities.” Mutual funds must have efficient, orderly markets to invest cash they receive when investors purchase fund shares as well as to meet investor redemption requests on a daily basis.

Registered funds also are dependent on adequate liquidity when making investment decisions and when trading the instruments in which they invest. Important investment criteria analyzed by portfolio managers at registered funds include a security’s liquidity, i.e., whether a position can easily be sold in a timely and cost efficient manner. If registered funds cannot transact effectively in the financial markets due to a lack of liquidity, they may be reluctant to invest in certain instruments altogether.

We are concerned that the Proposed Rule would decrease liquidity, particularly for those markets that rely most on banking entities, such as the fixed income and derivatives markets and the less liquid portions of the equities markets. A reduction of liquidity would have serious implications for registered funds, ultimately leading to the potential for higher costs for fund shareholders. Non-U.S. retail funds similarly are apprehensive about the prospect of decreased liquidity in these markets, both in the United States, where many of these funds trade, and abroad (particularly with respect to obligations of foreign governments and international and multinational development banks).

B. The Complexity of, and Difficulties of Complying with, the Proposed Rule Threaten Market Liquidity and May Adversely Impact Registered Funds

Much of the concern surrounding the effect of the Proposed Rule on liquidity arises from the complexities of several provisions of the Proposed Rule and of the exemptions from the proprietary trading prohibition. We support recasting the rigid criteria that appear in the Proposed Rule as “guidance” to be incorporated into policies and procedures adopted by banking entities. These policies and procedures could be combined with a robust compliance program required to be employed by banking entities, the use of relevant quantitative metrics to evaluate banking entity trading activity, and examinations by the Agencies to ensure that banks are not engaged in speculative proprietary trading. Together, these measures should accomplish the purposes of the Volcker Rule while permitting the sort of market making activity upon which registered funds and other investors rely.

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15 See Section 2(a)(32) of the Investment Company Act (generally defining “redeemable security” as “any security ... under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled ... to receive approximately his proportionate share of the issuer’s current net assets, or the cash equivalent thereof.”).
1. *The Presumption of Prohibited Activity is Unwarranted*

The Proposed Rule generally presumes that a banking entity’s short-term principal trading activity is prohibited proprietary trading. While the Proposed Rule provides a mechanism to rebut this presumption, doing so appears extremely complex and onerous. Inevitably, it would expose a banking entity to hindsight interpretations and second-guessing about key compliance decisions with respect to each individual financial position.

This presumption of prohibited activity fundamentally prejudices the analysis of a banking entity’s trading activity from the outset. Given the difficulties of overcoming the presumption, banking entities understandably will be highly reluctant to make markets with respect to any instrument that might fall within the proprietary trading prohibition.

2. *The Conditions of the Exemptions Do Not Reflect the Operation of the Financial Markets as a Whole*

The Proposed Rule appears tailored primarily for the operations of the traditional trading of equities on an agency-based “last sale” model (i.e., on the securities exchanges), the operations of which differ substantially from how the fixed-income and other markets operate. In the majority of the financial markets, market makers provide liquidity by acting as principal, and not as agent. The Proposed Rule therefore does not reflect accurately the manner in which those other financial markets operate: fixed-income securities and derivatives are traded “over-the-counter” rather than on exchanges; their instruments are not as liquid as equities; and the markets and their instruments are more fragmented. As a result, the role of market makers in fixed-income securities and derivatives is more complex and more fundamental to how these markets operate. We are therefore concerned that the Proposed Rule will inhibit the ability of banking entities to conduct market making activities effectively across various asset classes and to supply needed liquidity by acting as principal in a transaction.

The Proposed Rule also does not accord banking entities the flexibility they need as market makers to enter into transactions to build inventory, which is a significant element of making a market. As a result, the exemptions provided in the Proposed Rule from the proprietary trading prohibition, particularly the exemption for market making-related activities, likely will be of very limited utility for banking entities. If that is the case, trading activity that registered funds rely on will be restricted, negatively impacting transaction costs, increasing shareholder risk, and ultimately impacting fund shareholder returns.

3. *The Conditions of the Proposed Exemption for Market Making-Related Activities are Impractical*

The Proposed Rule’s implementation of Section 619’s exemption for market making-related activities contains numerous conditions that must be met by a banking entity. We believe these
conditions, as currently drafted, make the exemption extremely complex and so difficult to comply with as to be effectively unworkable in a number of financial markets and for a significant number of financial instruments. For example, the Proposed Rule would require banking entities to ensure that their market making activities generate revenues primarily from fees, commissions, bid/ask spreads or other income that is not attributable to appreciation in the value of covered financial positions held as inventory or hedging of such covered financial positions. As discussed above, market making in fixed-income and derivatives instruments simply does not function in that way, as market makers provide liquidity by acting as principal, and not as agent, in these markets. This condition ignores the fact that market makers holding inventory may seek to generate revenue and profit from the appreciation, and avoid losses from the depreciation, of the covered financial position during the time they hold the position in inventory. Similarly, in less liquid markets where trades are infrequent and customer demand is hard to predict, it may be difficult for a market maker to satisfy the condition that its activity be “designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.”

4. The Risk-Mitigating Hedging Exemption Must be Flexible

The ability of banking entities as market makers to hedge their positions and manage the risks taken in connection with their activities is a critical element of a liquid and efficient market. It is therefore imperative to ensure that banking entities can hedge their positions appropriately to allow them effectively to provide needed services to registered funds. The Proposed Rule’s risk-mitigating hedging exemption should not apply on a transaction-by-transaction basis. Rather, it should be flexible enough to allow banking entities to manage all possible risks and to facilitate hedging against overall portfolio risk.

5. The Proposed Government Obligations Exemption Should be Expanded to Cover All Municipal Securities and Foreign Sovereign Obligations

The proposed exemption for trading in certain government obligations does not extend to transactions in obligations of an agency or instrumentality of any State or political subdivision. We submit that there is no rational basis upon which to exclude this particular class of municipal securities. These instruments represent one of the more conservative asset classes in the capital markets, and registered funds are significant investors in these securities. Excluding this class of municipal securities will restrict trading in these instruments and pose liquidity challenges for registered funds holding these securities. Moreover, it will impair the ability of many local government entities to raise capital, with significant adverse consequences for the finances of these entities. We therefore recommend that the exemption be expanded, either in the statute or the implementing regulations, to include all municipal securities, which would be consistent with the current definition of municipal securities under the Securities Exchange Act of 1934 ("Exchange Act"). We further recommend that there be an exemption for foreign sovereign obligations, consistent with Congressional intent to limit the extraterritorial reach of the Volcker Rule and with the purposes of the Volcker Rule.
C. The Agencies’ Proposed Implementation of the Proprietary Trading Prohibition Would Impact Capital Formation

The Agencies’ proposed implementation of the proprietary trading prohibition could have negative implications for capital formation. Banking entities play a critical role in initial capital formation, often providing companies with the capital necessary to go public. If banking entities find that the restrictions contemplated by the Proposed Rule prohibit or greatly impede their serving this role, they will be less willing to provide capital, adversely affecting registered funds and other investors. Similarly, if issuers and dealers face increased costs in the capital formation process due to the Proposed Rule, this could restrict access for registered funds to suitable investments, and the availability of investments for registered funds overall will decline.

Banking entities also may find it difficult to remain in the market making business, which could lead these activities to be performed by less regulated and less transparent institutions. We therefore believe the over-broad restrictions of the Proposed Rule, which go well beyond what is necessary to effectuate Congress’ intent in enacting Section 619 of the Dodd-Frank Act, could hurt the broader economy, impacting job creation and investments in U.S. businesses overall.

IV. LIMITING INVESTMENT OPPORTUNITIES FOR REGISTERED FUNDS AND THEIR SHAREHOLDERS

A. The Foreign Trading Exemption Should Be Revised to Avoid Adverse Effects on Investments in Certain Foreign Securities by U.S. Registered Funds and Their Foreign Counterparts

Although Congress intended that trading outside of the United States be a “permitted activity” under the Volcker Rule, the Proposed Rule narrowly defines transactions deemed to take place outside of the United States. In so doing, the Proposed Rule departs from an existing and well-understood U.S. securities regulation (Regulation S under the Securities Act of 1933) that governs whether an offering takes place outside of the United States. If left unaddressed, the discrepancy between the “foreign trading exemption” in the Proposed Rule and the long-established Regulation S standard would have negative consequences for U.S. registered funds and their shareholders.

Many registered funds invest in securities, such as sovereign debt securities denominated in foreign currency, for which the primary and most liquid market is outside of the United States. These transactions often involve non-U.S. banking entities as counterparties. The narrow foreign trading exemption in the Proposed Rule may well cause some non-U.S. banking entities to avoid engaging in transactions with persons acting on behalf of U.S. registered funds, even when those transactions would comport fully with Regulation S and related SEC interpretations. As a result, U.S. registered funds’ access to non-U.S. counterparties could decrease significantly.

As currently configured, the foreign trading exemption also could reduce liquidity in some markets and lead to smaller or more fragmented markets for many securities. This would have adverse effects on investors in those markets including both U.S. registered funds and non-U.S. retail funds.
Revising the Proposed Rule (or the statute) to conform to the existing approach under Regulation S would avoid these highly undesirable results.

B. The Volcker Rule Should Exempt Asset-Backed Commercial Paper and Municipal Tender Option Bond Programs

The Proposed Rule would impair two particular types of securitization activities that are part of traditional banking activities—notes issued by asset-backed commercial paper (“ABCP”) programs and securities issued pursuant to municipal tender option bond (“TOB”) programs. This would have significant negative implications for issuers of these financing vehicles and their investors, many of which are registered funds. There is no indication, however, that Congress intended to include ABCP or municipal TOB programs within the scope of the Volcker Rule; rather, Congress specifically sought to avoid interfering with longstanding, traditional banking activities. The provision of credit to companies to finance receivables through ABCP, as well as to issuers of municipal securities to finance their activities through TOBs, are both areas of traditional banking activity that should be distinguished from the types of financial activities that Congress sought to restrict under the Volcker Rule. Without liquid ABCP and TOB markets, credit funding for corporations and municipalities would be unduly and unnecessarily constrained. It is therefore important that the statute or implementing regulations be revised to exempt ABCP and municipal TOB programs.

V. CONCLUSION

I appreciate the opportunity to share these views with the Committee. ICI looks forward to working with Congress and regulators as they continue to tackle these and other important issues.

Attachment

- Appendix: Proposed Amendments to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Volcker Rule”)
APPENDIX

Proposed Amendments to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Volcker Rule”)\(^6\)

I. **Amendments to Clarify that the Volcker Rule Does Not Extend to U.S. Mutual Funds or Their Non-U.S. Counterparts**

A. **Amendment to Section 13(h)(2) of the Bank Holding Act of 1956, which defines the terms “hedge fund” and “private equity fund”:**

Add the following language at the end of the paragraph:

*In no event shall the terms “hedge fund” or “private equity fund” (including any similar fund as designated by rule) mean—*

(A) an investment company registered under the Investment Company Act of 1940;

(B) an issuer organized or formed under foreign law that is authorized for public sale in the jurisdiction in which it is formed and is regulated as a public investment company, regardless of the form of organization, in that jurisdiction; or

(C) an issuer that is subject to contractual or other restrictions that effectively limit its investment objectives, policies and strategies to those objectives, policies and strategies that would be permitted for investment companies registered under the Investment Company Act of 1940.

**EXPLANATION:**

- Section 619 of the Dodd-Frank Act prohibits a banking entity from having an ownership interest in, or acting as sponsor to, a hedge fund, private equity fund, or “similar fund” as the agencies charged with implementing the Volcker Rule may determine by rule.

- Treating *any* mutual fund or other U.S. registered investment company as “similar” to a hedge fund or private equity fund is contrary to Congressional intent. If the term “similar fund” is interpreted broadly by the regulators, however—as we have seen in the pending proposal to implement the Volcker Rule—some registered funds may become subject to the Volcker Rule prohibitions. Providing an express exclusion for mutual funds and other U.S. registered investment companies

\(^6\) Section 619 added Section 13 (Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds) to the Bank Holding Company Act of 1956.
from the definition of “hedge fund” and “private equity fund” would avoid this result.

- There likewise should be an express exclusion for non-U.S. retail funds from the definition of “hedge fund” and “private equity fund” to treat them similarly to their U.S. mutual fund counterparts. Like U.S. registered investment companies, non-U.S. retail funds are regulated in areas such as how they may invest and operate, the disclosure they must provide to their investors, the means by which they value their portfolio securities, their corporate governance, and their use of leverage, in order to be widely offered to retail investors. They are not managed or structured like hedge funds or private equity funds and so should never be categorized as “similar funds.”

- Without such a corollary exclusion for non-U.S. retail funds, the Volcker Rule would be applied more restrictively outside the United States. Further, providing an express exclusion for non-U.S. retail funds from the definition of “hedge fund” and “private equity fund” is consistent with Congressional intent to limit the extraterritorial impact of the Volcker Rule.

- The language of the proposed exclusion for non-U.S. retail funds is substantially similar to that used by the Securities and Exchange Commission in 2004, when it identified the types of non-U.S. funds that should not be treated as hedge funds. As in the SEC’s rulemaking, the proposed exclusion should apply to any type of publicly offered fund otherwise meeting the requirements of the exclusion, whether in corporate, trust, contractual or other form.

- It also is unnecessary to apply the Volcker Rule prohibitions to funds that, because of contractual or other restrictions, effectively limit their investment objectives, policies and strategies to those that would be permitted for U.S. registered investment companies under the Investment Company Act of 1940 (e.g., limitations on leverage). These parameters are well understood by the investment management industry and by the SEC, which is the primary regulator of registered investment companies and advisers to certain hedge funds and private equity funds.

- In addition, excluding the funds described in (C) above from the scope of Section 619 would be consistent with the Financial Stability Oversight Council’s recommendation that the “similar fund” designation be reserved for funds that “engage in the activities or have the characteristics of a traditional private equity fund or hedge fund.”

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17 See Registration under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333 (Dec. 2, 2004). This rulemaking was vacated by the U.S. Court of Appeals for the District of Columbia Circuit on grounds unrelated to this particular provision. See Goldstein v. Sec. & Exch. Comm’n, 451 F.3d 873 (D.C. Cir. 2006).

B. Amendment to Section 13(h)(1) of the Bank Holding Company Act of 1956, which defines the term “banking entity”:

Add the following language at the end of the paragraph:

In no event shall the term “banking entity” mean—

(A) an investment company registered under the Investment Company Act of 1940;

(B) an issuer organized or formed under foreign law that is authorized for public sale in the jurisdiction in which it is formed and is regulated as a public investment company, regardless of the form of organization, in that jurisdiction; or

(C) an issuer that is subject to contractual or other restrictions that effectively limit its investment objectives, policies and strategies to those objectives, policies and strategies that would be permitted for investment companies registered under the Investment Company Act of 1940.

EXPLANATION:

• The Volcker Rule prohibits a “banking entity” from engaging in proprietary trading and from sponsoring or investing in hedge funds and private equity funds. The definition of “banking entity” includes an affiliate or subsidiary of a banking entity.

• A mutual fund generally is not considered an affiliate or subsidiary of the banking entity that sponsors or advises it. Without an express exclusion, however, it is possible that some mutual funds or other U.S. registered investment companies could become subject to all of the prohibitions and restrictions in the Volcker Rule—a result not intended by Congress. For example, during the period following the launch of a new mutual fund by a bank-affiliated sponsor, when all or nearly all of the fund’s shares are owned by that sponsor (the “seeding process” for a new fund), the mutual fund could be considered an affiliate of the banking entity, and thus subject to the Volcker Rule in its own right.

• Providing an express exclusion for mutual funds (and other U.S. registered investment companies) from the definition of “banking entity” would avoid this unintended result without thwarting in any way the policy goals of the Volcker Rule.

• Consistent with Congress’ intent to limit the extraterritorial impact of the Volcker Rule, the exclusion also should extend to non-U.S. retail funds (i.e., the non-U.S. counterparts to U.S. mutual funds). Like U.S. registered investment companies, non-U.S. retail funds are regulated in areas such as how they may invest and operate, the disclosure they must provide to their investors,
the means by which they value their portfolio securities, their corporate governance, and their use of leverage, in order to be widely offered to retail investors.

- The language of the proposed exclusion for non-U.S. retail funds is substantially similar to that used by the SEC in 2004, when it identified the types of non-U.S. funds that should not be treated as hedge funds.\textsuperscript{19} As in the SEC’s rulemaking, the proposed exclusion should apply to any type of publicly offered fund otherwise meeting the requirements of the exclusion, whether in corporate, trust, contractual or other form.

- It also is consistent with Congressional intent to exclude from the definition of “banking entity” funds that, because of contractual or other restrictions, effectively limit their investment objectives, policies and strategies to those that would be permitted for U.S. registered investment companies under the Investment Company Act of 1940 (e.g., limitations on leverage). Such funds do not present the risks at which the Volcker Rule prohibitions are directed.

II. **Amendment to Clarify that the Volcker Rule Permits Market Making Activity by Authorized Participants in Exchange-Traded Funds**

Insert the following language as Section 13(d)(1)(C), (and redesignate successive subparagraphs (C) through (J) as (D) through (K)):

(C) The purchase, sale, acquisition, or disposition of securities issued by Exchange-Traded Funds (“ETF Shares”), or underlying securities held by an ETF (or other instruments reasonably intended to provide substantially similar economic exposure)

(i) in connection with ETF market making-related activities, or

(ii) by Authorized Participants in connection with the creation and redemption of ETF Shares.

EXPLANATION:

- Exchange-traded funds (“ETFs”) have over $1 trillion in assets under management, and are an important investment vehicle for a wide range of investors. A robust trading environment is critical for the ETF market.

- Banking entities play an important role in this market by acting as Authorized Participants (“APs”) and market makers. An AP is an entity that enters into a contract with an ETF permitting it to purchase and sell shares directly with the ETF at the ETF’s net asset value.

\textsuperscript{19} See Registration under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333 (Dec. 2, 2004). This rulemaking was vacated by the U.S. Court of Appeals for the District of Columbia Circuit on grounds unrelated to this particular provision. *See Goldstein v. Sec. & Exch. Comm’n*, 451 F.3d 873 (D.C. Cir. 2006).
• In their role as APs and market makers, banking entities may, among other things:

1. “Seed” new ETFs, by providing initial capital and holding shares of an ETF until a liquid trading market develops.

2. Engage in short term arbitrage transactions, creating ETF shares when such shares trade at a premium (i.e., when demand exceeds supply) and redeeming them when they trade at a discount (i.e., when supply exceeds demand); this activity helps to keep the market price for ETF shares close to their net asset value. The SEC views this arbitrage process as a critical component of maintaining efficient pricing in the ETF marketplace and protecting ETF investors from the risks of substantial and sustained deviations from net asset value.\textsuperscript{20}

3. Temporarily hold inventory of ETF shares and the underlying securities or their economic equivalent in order to maintain efficient pricing for ETFs.

• These activities may fall within the definition of “proprietary trading” in subsection (h)(4) of Section 13, and they do not clearly fit within the “permitted activities” exemptions enumerated in subsections (d)(1)(A) through (I) of Section 13.

  o Although the activities described above relate to market making in ETF shares, the existing exemption in subsection (d)(1)(B) for market making-related activities is too narrow because of its requirement that such activities be “designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.”

• These activities relating to ETF shares do not create the risks that the Volcker Rule was intended to address.

• The proposed change would provide certainty to the ETF marketplace that banking entities can continue to act as APs and engage in market making-related activity with respect to ETF shares. Other ways to achieve this objective include:

  o Revising the definition of “proprietary trading” in Section 13(h)(4) to exclude trading in ETF shares and underlying securities held by an ETF (or other instruments reasonably intended to provide substantially similar economic exposure).

\textsuperscript{20} A primary concern for the SEC in its efforts to establish a regulatory framework for ETFs was to ensure that the process for this type of trading could function effectively. See Part IV.B of SEC Release No. IC-25258 (November 17, 2001). ETF exemptive orders contain conditions specifically designed to provide for a sufficiently robust, but controlled, arbitrage process. See, e.g., In the Matter of Pacific Investment Management Company LLC, et al SEC Release Nos. IC-28949 (October 20, 2009 (notice)) and IC-28993 (November 10, 2009 (order)); and In the Matter of Claymore Exchange-Traded Fund Trust 3, et al SEC Release Nos. IC-29256 (April 23, 2010 (notice)) and IC-29271 (May 18, 2010 (order)).
Directing the agencies charged with implementation of the Volcker Rule to ensure that the activities permitted under the market making exemption in Section 13(d)(1)(B) include the activities described herein.

III. Amendment to Expand the Government Obligations Exemption

Revise Section 13(d)(1)(A) of the Bank Holding Company Act of 1956 as follows:

(A) The purchase, sale, acquisition, or disposition of obligations of the United States or any agency thereof, obligations, participations, or other instruments of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution charted under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.), and obligations of any State or of any political subdivision thereof, municipal securities, as defined in section 3(a)(29) of the Securities Exchange Act of 1934.

EXPLANATION:

• The Section 619 exemption for trading in certain government obligations does not extend to transactions in obligations of an agency or instrumentality of any State or political subdivision. The exemption should be expanded to include these securities, which would be consistent with the current definition of municipal securities under the Securities Exchange Act of 1934.

• Obligations issued by state agencies and instrumentalities represent one of the more conservative asset classes in the capital markets, and are estimated to account for almost half of the securities currently outstanding in the municipal securities market.

• Banking entities currently play a significant role in underwriting and facilitating a secondary market for municipal securities of agencies and instrumentalities. Failure to include such trading as a permitted activity would impair the ability of many local government entities to raise capital, with significant adverse consequences for the finances of these entities.

IV. Amendment to Clarify the Scope of the Permitted Activity Exemptions Involving Transactions and Activities Occurring Solely Outside the United States

Add the following paragraph as new subsection (i) of Section 13 of the Bank Holding Company Act of 1956:
(i) For purposes of determining which transactions and activities are considered to be “permitted activities” within the meaning of subsection (d) or otherwise outside the scope of the prohibitions in this section, any transaction or activity that takes place in accordance with Regulation S under the Securities Act of 1933, and interpretations thereunder, shall be deemed to have occurred “solely outside the United States.” In addition, the term “resident of the United States” shall mean a “U.S. person” as defined in Regulation S under the Securities Act of 1933, and interpretations thereunder.

EXPLANATION:

• Congress expressly limited the extraterritorial application of the Volcker Rule through two “permitted activity” exemptions: (1) an exemption for trading conducted by a non-U.S. banking entity solely outside the U.S. (known as the foreign trading exemption), and (2) an exemption for investment fund activities by a non-U.S. banking entity solely outside the U.S. (known as the foreign fund exemption).

• For more than 20 years, Regulation S under the Securities Act of 1933 has been the global standard for delineating the U.S. and non-U.S. securities markets. Regulation S governs whether a securities offering takes place outside of the U.S. and therefore is not subject to U.S. registration requirements. Market participants around the world, including U.S. registered investment companies, have built their compliance systems and processes based on Regulation S.

• There is no indication that Congress intended to create a new or different standard for delineating U.S. and offshore securities activities for purposes of the Volcker Rule. Unfortunately, the pending proposal to implement the Volcker Rule would depart from the existing Regulation S standard, by narrowly defining the transactions that would be considered to take place outside the United States. Such an approach could have negative consequences for U.S. registered funds and their shareholders.

• For example, many U.S. registered funds with foreign subadvisers invest in securities, such as sovereign debt securities denominated in foreign currency, for which the primary and most liquid market is outside of the United States. These transactions often involve non-U.S. banking entities as counterparties. If the Volcker Rule is interpreted too narrowly, some non-U.S. banking entities may avoid engaging in transactions with persons acting on behalf of U.S. registered funds. As a result, U.S. registered funds’ access to non-U.S. counterparties could decrease significantly, and liquidity in some markets could be reduced.

• Including an express statement in the statute that the foreign activity exemptions (and the Volcker Rule generally) should operate consistent with Regulation S and interpretations thereunder would avoid these highly undesirable results.
V. Amendments to Clarify that the Volcker Rule Does Not Extend to Asset-Backed Commercial Paper or Tender Option Bond Programs

A. Amendment to Section 13(h)(2) of the Bank Holding Act of 1956, which defines the terms “hedge fund” and “private equity fund”:

Add the following language at the end of the paragraph:

In no event shall the terms “hedge fund” or “private equity fund” (including any similar fund as designated by rule) mean:

(A) an issuer that is a Special Purpose Entity as defined in Rule 2a–7 under the Investment Company Act of 1940 (17 CFR 270.2a–7(a)(3)), the assets or holdings of which are substantially comprised of Qualifying Assets, as defined in Rule 2a–7 (17 CFR 270.2a–7(a)(3)); or

(B) an issuer that is a trust, the assets or holdings of which are substantially comprised of municipal securities, as that term is defined in Section 3(a)(29) of the Securities Exchange Act of 1934.

B. Amendment to Section 13(h)(1) of the Bank Holding Company Act of 1956, which defines the term “banking entity”:

Add the following language at the end of the paragraph:

In no event shall the term “banking entity” mean—

(A) an issuer that is a Special Purpose Entity as defined in Rule 2a–7 under the Investment Company Act of 1940 (17 CFR 270.2a–7(a)(3)), the assets or holdings of which are substantially comprised of Qualifying Assets, as defined in Rule 2a–7 (17 CFR 270.2a–7(a)(3)); or

(B) an issuer that is a trust, the assets or holdings of which are substantially comprised of municipal securities, as that term is defined in Section 3(a)(29) of the Securities Exchange Act of 1934.

EXPLANATION:

- The Volcker Rule prohibits a “banking entity” from engaging in proprietary trading and from having an ownership interest in or sponsoring a “hedge fund” or a “private equity fund.” The definition of “hedge fund” and “private equity fund” includes an issuer that would be an investment company, as defined in the Investment Company Act of 1940, but for Section 3(c)(1)
or 3(c)(7) of that Act. The definition of “banking entity” includes an affiliate or subsidiary of a banking entity.

- In enacting the Volcker Rule, Congress specifically sought to avoid interfering with longstanding, traditional banking activities. Without further clarification, however, the Volcker Rule would impair two types of securitization activities that are part of traditional banking activities—notes issued by asset-backed commercial paper (“ABCP”) programs and securities issued pursuant to municipal tender option bond (“TOB”) programs.

- Application of the Volcker Rule to ABCP and TOB programs would have significant negative implications for issuers of these financing vehicles and their investors, many of which are U.S. registered funds. The provision of credit to companies to finance receivables through ABCP, as well as to issuers of municipal securities to finance their activities through TOBs, are both areas of traditional banking activity that should be distinguished from the types of financial activities that Congress sought to restrict under the Volcker Rule. Without liquid ABCP and TOB markets, credit funding for corporations and municipalities would be unduly and unnecessarily constrained.

- Although application of the Volcker Rule to these programs clearly was not intended by Congress, clarification is needed because ABCP and TOB issuers typically rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. As a result, they would be captured by the definition of “hedge fund” or “private equity fund,” despite the fact that they have none of the characteristics of a hedge fund or private equity fund. Similarly, an ABCP or TOB program would fall within the definition of “banking entity” if it were considered an affiliate of a banking entity (e.g., because the banking entity is acting as sponsor of that ABCP or TOB program). To address these concerns, ABCP and TOB programs should be expressly excluded from the definition of “hedge fund” and “private equity fund” and from the definition of “banking entity.”

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The specific recommendations outlined above address only a fraction of the very significant concerns about the Volcker Rule that have been voiced by many stakeholders and that should be considered as part of any effort to develop a less burdensome alternative. As part of any such alternative, the Committee should include a conformance period of sufficient length that would begin to run upon adoption of final implementing rules by the various regulatory agencies. It is imperative that banking entities and other market participants be given adequate time to understand the new regulatory requirements and to adjust their business models and practices accordingly. Structuring the conformance period in this way would allow an orderly transition and minimize market disruptions.