

ICI VIEWPOINTS

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Proposal to Implement the Volcker Rule Raises Deep Concerns for U.S. Registered Funds

By Paul Schott Stevens

Congress enacted the provision of the Dodd-Frank Act known as the Volcker Rule to restrict banks from using their own resources to trade for purposes unrelated to serving clients—something known as “proprietary trading.” Congress did not direct the Volcker Rule at mutual funds or other registered investment companies. Nonetheless, the way in which regulators have proposed to implement the provision raises deep concerns for U.S. funds. ICI has submitted a detailed [comment letter](#) in response to this [proposal](#).

This summary of the ICI comment letter looks at the impact of the rule both on markets generally and on the fund industry specifically.

The big picture: The proposal could do serious harm to U.S. financial markets and to investors, including registered funds and their shareholders. The proposal would inhibit banks from conducting market making activities, thereby reducing liquidity in the financial markets—particularly the fixed income and derivatives markets and the less-liquid portions of the equities markets. Less liquidity has serious implications for registered funds: it leads to wider bid-ask spreads, increased market fragmentation, and ultimately higher costs for fund shareholders. It also could alter the structure of the U.S. financial markets, impair capital formation, and make it difficult for banking entities to remain as market makers. If they can't, this activity could shift to less-regulated and less-transparent financial institutions.

The specific impact on mutual funds: The proposal would impede the organization, sponsorship, and normal activities of registered mutual funds—for example, by applying the Volcker Rule's hedge fund restrictions to many registered funds, contrary to Congressional intent.

To address this problem, the proposed rule should be revised to exclude all registered funds from the definitions of “covered fund” and “banking entity.” In addition, the proposal should be revised to ensure that banking entities can continue to serve as so-called authorized participants, which are vitally important to the market for exchange-traded funds.

The proposal could limit investment opportunities for registered funds and their shareholders.

The narrow exemption in the proposed rule for trading outside of the United States could significantly limit U.S. registered funds' access to non-U.S. counterparties. To avoid this, any final rule should adhere closely to the approach taken under the Securities and Exchange Commission's (SEC's) Regulation S, a regulation governing whether a securities offering takes place outside the United States. The proposal could deter banks from engaging in traditional activities such as sponsorship of asset-backed commercial paper (ABCP) and tender option bond (TOB) programs, activities Congress in no way sought to restrict. Any final rules should exempt ABCP and TOB programs.

- In a related [video](#), Stevens discusses the Volcker Rule proposal's impact on registered investment companies.
- ICI submitted a [statement](#) for a joint House subcommittee hearing January 18 on the impact of the Volcker Rule
- Additional resources on financial regulatory reform are posted on the Institute's [Financial Services Regulatory Reform Resource Center](#).

Paul Schott Stevens was President and CEO of ICI.

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