

**MEMO# 24709**

November 15, 2010

## **ICI Letter on FSOC Request for Information on Volcker Rule**

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TO: SEC RULES MEMBERS No. 121-10  
EQUITY MARKETS ADVISORY COMMITTEE No. 44-10  
CLOSED-END INVESTMENT COMPANY MEMBERS No. 59-10  
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 31-10  
ETF ADVISORY COMMITTEE No. 49-10 RE: ICI LETTER ON FSOC REQUEST FOR INFORMATION ON VOLCKER RULE

As we previously informed you, the Financial Stability Oversight Council ("FSOC") issued a request for information on the "Volcker Rule" contained in Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 619 requires that FSOC conduct a study of the Volcker Rule, which study must be considered by the relevant regulatory agencies in implementing the Rule's provisions. ICI has filed a comment letter, a copy of which is attached, on the request for information. The ICI's letter focuses on the impact on funds of the Volcker Rule's prohibition on proprietary trading and highlights potential unintended consequences for funds and their advisers under the Rule.

### **Impact of Volcker Rule on Trading by Funds**

The Volcker Rule, among other things, prohibits "banking entities" from engaging in "proprietary trading." The Rule, however, recognizes the need to permit certain types of proprietary trading and provides exceptions for a number of "permitted activities."

The letter notes that banking entities provide crucial execution services and liquidity to the securities market, which activities should be permitted under the exceptions to the Rule. Most significant to funds, banking entities provide liquidity and capital commitment in support of trading activities of funds, in a variety of asset classes and under a number of different circumstances, both through market making activities and as "block positioners." These activities are important to funds that want to buy or sell a large amount of stock quickly but that could be disadvantaged by placing the large order into the market all at

once.

The letter states that it is important to provide guidance to make clear that the definitions of, for example, “market making related activities” and “on behalf of a customer” include the activities banking entities may conduct when providing execution and trading services to funds. The letter therefore recommends that the FSOC study clarify that these types of services and activities are covered under the permitted activities exception. The letter states that construing the permitted activities exception in this manner would not impede achieving the Rule’s goals or pose risks to banking entities that the Rule was designed to address.

## **Potential Unintended Consequences for Funds and Their Advisers**

The letter describes several potential unintended consequences for funds and their advisers that may occur due to the prohibition on proprietary trading and asks that FSOC’s recommendations for Volcker Rule implementation advise the relevant regulatory agencies to avoid these outcomes.

First, the letter asks FSOC to recommend that investment adviser investments of seed capital to launch new mutual funds (or other registered investment companies) should not be considered “proprietary trading” for purposes of the Volcker Rule. The letter states that an adviser’s provision of seed capital to a mutual fund or other registered investment company does not pose the conflicts of interest that the Volcker Rule seeks to prohibit and that the Congressional drafters of the Rule did not intend to capture this practice under the definition of “proprietary trading.”

Second, the letter notes that the Federal Reserve Board has long viewed mutual funds and other registered investment companies as being controlled by their independent boards of directors and not by their advisers or the other entities that provide the funds with administrative, brokerage, and other services. The letter therefore asks that FSOC recommend to the regulatory agencies that they affirm this interpretation and expressly confirm that funds are not brought within the scope of the term “banking entities” or otherwise subjected to the Rule by virtue of their relationship to banking entities.

Finally, the letter requests that FSOC recommend that investments by a banking entity in shares of money market funds not be considered “proprietary trading” for purposes of the Volcker Rule. The letter states that banking entities may purchase and sell shares of money market funds as principal for their trading accounts for cash management purposes and that, as a technical matter, this activity could fall within the broad definition of “proprietary trading.”

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[Attachment](#)

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