Heavy Hitters Voice Concerns on Volcker Rule

By Peter Ortiz
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Vanguard, **BlackRock** and the Investment Company Institute are among the heavy hitters voicing concern about the so-called Volcker Rule and requesting that regulators grant more time to weigh in on the pending regulation.

Vanguard and BlackRock joined with other large institutional managers as signatories to The Credit Roundtable comment letter warning that the proposed rule in its current form would pose trouble for registered investment companies.

The Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), Treasury, Federal Reserve and Federal Deposit Insurance Corporation have all requested comment on the proposed rule required by Dodd-Frank that would impose certain prohibitions on banking entities and non-bank financial companies to engage in proprietary trading.

The SEC did grant an extension to its original Jan. 13 deadline to Feb. 13, but it is still less time than commenters sought. The Credit Roundtable and the ICI did not acknowledge the new Feb. 13 date in their respective comments, as both filed their letters before the SEC granted the extension.

The Credit Roundtable group and the ICI suggested that a deadline of 90 days after the original Jan. 13 deadline or 60 days after the CFTC releases its proposed rule, whichever is later. The CFTC also is required to come up with a rule proposal, and has suggested that it may put forth its proposal this month.

"We are deeply concerned about certain potentially far reaching and unintended consequences of the Proposed Rules, including reduced liquidity in the markets, higher trading costs and reduced valuation of fixed income securities," reads the Credit Roundtable's letter. "We are especially concerned about the effect of these consequences on tens of millions of individual investors, and institutional clients such as pension funds, 401(k) plans, foundations and endowments."

A major concern with the proposal is the potentially major negative impact it could have on trading in the bond market because of reduced liquidity, says Bob Auwaerter, head of the fixed income group at Vanguard. The proposal would prevent dealers from holding securities on their balance sheets while they look for buyers. The goal is to minimize the risk from a security's decreasing in price while the dealer tries to match buyers and sellers.

"The idea is that under the Volcker Rule the only way [dealers] make money is via commissions and matching buyers and sellers at the time when transactions take place, and the bond markets just don't work that way," Auwaerter says. "Usually there is a lag and the dealer has to hold the security in its inventory."

While not speaking for the other signatories, Auwaerter says the Feb. 13 comment extension from the SEC should be sufficient for his firm to address its concerns.

Other firms to sign on to the letter include **Dodge & Cox**, **Loomis, Sayles & Company**, **MetLife** and **Nationwide Mutual Insurance Company**. The ICI also requested a comment extension to deal with the proposed rule's complexity and the request by regulatory agencies to respond to the "hundreds of questions" on the proposal.

"Our comments will focus on the potential impact of the Proposed Rule on registered investment companies (e.g., mutual funds) and their shareholders, including how the proposal would affect registered investment companies as major investors in the securities markets and otherwise," writes Paul Schott Stevens, president and CEO of the ICI.

Stevens writes that a comment extension will afford his group time to address concerns about the proposal, which, while not directed at registered investment companies, is causing consternation.

“We continue to discover new, unexpected and, we believe[,] unintended negative implications for registered investment companies and their shareholders,” he writes.

Karrie McMillan, general counsel with the Investment Company Institute, also cautioned that “funds have good reason to worry about the market impact of the [Volcker] rule,” at a securities law conference in December. She stressed how the rule could “fundamentally change the way fixed-income securities are traded,” and expressed concern over the rule’s broad definition of what is a covered fund.

“For example, by including commodity funds in the definition of a ‘covered fund,’ the proposal, if read broadly, could sweep in any funds, including mutual funds, that invest in even one futures contract,” McMillan said. “Finally, the rule’s broad definition of ‘covered fund’ could also pick up many issuers of asset-backed securities, with significant implications for funds and other investors.”

For their part, SEC commissioners Daniel Gallagher and Troy Paredes think the extension to Feb. 13 is “insufficient given the complexities of the Volcker Rule proposal.”

“This proposal also has the potential to dramatically and irrevocably impact the U.S. financial markets. Accordingly, the comment period extension should have been longer to help ensure the integrity and soundness of the rulemaking process,” they wrote in a joint statement.