

Criticism of ‘Volcker Rule’ Comes from Abroad

Japan Worries Over Government Bond Liquidity, International Bankers Raise NAFTA Question

Japan’s central bank and its primary securities regulator expressed concern over the “Volcker Rule” and its potential adverse effects on Japan’s government bond market in a Dec. 28 letter to U.S. regulators as part of the rule’s public comment period.

The rule, named after Carter- and Reagan-era Federal Reserve chairman Paul Volcker, prohibits deposit-taking institutions from engaging in proprietary trading, with a growing list of exceptions. The Bank of Japan (BOJ) and Japan’s Financial Services Agency (FSA) have asked for at least one more, to cover Japan government bonds.

“We are concerned that the proposed restrictions would have an adverse impact on Japanese government bonds (JGBs) trading,” the letter stated. “They would raise the operational and transactional costs of trading in JGBs and could lead to the exit from Tokyo of Japanese subsidiaries of U.S. banks.”

Regulators generally do not respond to nor comment on letters received as part of the official public comment period. A SEC spokesperson confirmed to Thompson Publishing Group that the commission would not comment on the letter from BOJ and FSA. However, comments that are well-taken and which are ultimately adopted in whole or in part in the final rule are typically discussed in the preamble to that rule.

President and Co-CEO of RBC Capital Markets — a subsidiary of Royal Bank of Canada — Mark Standish testified on the subject before Congress on behalf of the Institute of International Bankers (IIB) Jan. 18. He said, “Failure to create a regulatory exception for trading, as principal, in foreign government securities could undermine the liquidity of government debt markets outside of the U.S.” Standish, who cited the Dec. 28 letter from the BOJ and FSA, said the IIB “strongly favors” an exception to the Volcker Rule for trading in securities issued by international and multilateral development banks as well as foreign government securities. “At a minimum,” he testified, “the requirements of the Volcker Rule should be conformed to U.S. trade agreement and treaty obligations so that, for example, debt obligations backed by Canada and its political subdivisions would be given equal treatment as required by the North American Free Trade Agreement [NAFTA].”

It was not pinpointed in Standish’s written testimony to which part of NAFTA he was referring, but Chapter 14 of the 1994 treaty that created a trade bloc comprising the United States, Canada and Mexico, permits foreign and domestic banks in the U.S. to “deal in, purchase and underwrite Canadian government securities under the Glass-Steagall Act,” according to a summary by the Office of the U.S. Trade Representative.

Rebecca Laird, of counsel in the Washington, D.C. office of K&L Gates, said it is reasonable to believe that there should be an exemption from the Volcker Rule’s trading prohibitions for foreign government securities that are safe, not speculative and not given to wide variations in price. However, she cited certain foreign government bonds issued, for example, by some of the weaker members of the European Union as examples of securities that do not necessarily always exhibit these characteristics. Thus, she said, it would be reasonable to expect that they would not be exempted from the rule’s trading prohibitions. “It may be an uphill battle for BOJ and the IIB,” Laird said, “because the regulators will probably not want to get into differentiation among sovereign debt securities and also may not want to include metrics that would differentiate one country’s securities from another,” she said, “though doing nothing also has the real problems raised in [the BOJ’s and FSA’s] letter” and in Standish’s testimony.

Concerns over Extraterritorial Application of Rule

The BOJ/FSA letter raised the issue of extraterritorial application of regulations on foreign entities. “We are

See *Volcker Rule*, p. 11

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