

April 29, 2010

The Honorable Christopher Dodd
Chairman
Committee on Banking, Housing & Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Richard Shelby
Ranking Member
Committee on Banking, Housing & Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

Re: S. 3217, the Restoring American Financial Stability Act of 2010

Dear Chairman Dodd and Ranking Member Shelby:

I am writing on behalf of the Investment Company Institute¹ regarding the “Volcker rule” provisions in Section 619 of the Restoring American Financial Stability Act, as introduced on April 15.

In describing Section 619, the Committee Report accompanying S. 3217 states: “The intent of this section is to prohibit or restrict certain types of financial activity—in banks, bank holding companies, other companies that control an insured depository institution, their subsidiaries, or nonbank financial companies supervised by the Board of Governors—that are high-risk or which create significant conflicts of interest between these institutions and their customers.” We thus believe the Committee does not intend to include mutual funds within the scope of Section 619.

As currently drafted, however, the language of Section 619 could result in certain unintended consequences for mutual funds and their investors:

Mutual Fund Portfolio Transactions. In the unlikely event that a mutual fund were deemed systemically significant and made subject to supervision by the Federal Reserve under Title I of the bill, it is possible that the fund’s normal investment operations—that is, purchasing and selling securities and other financial instruments for the fund’s portfolio—would inadvertently fall within the broad definition of “proprietary trading.” In this situation, the mutual fund could become subject to Federal Reserve rules imposing capital requirements and quantitative limits, a result which would be inappropriate and unworkable. Funds have no ability to meet capital requirements—their only capital comes from the investors who own fund shares, and these shares in turn represent the shareholders’ ownership of undivided pro rata interests in all the

¹ The Investment Company Institute is 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 funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.66 trillion and serve almost 90 million shareholders.

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underlying assets of the fund. In addition, any quantitative limits are likely to be based upon banking law concepts and thus incompatible with the rigorous securities law standards and investor protections to which funds must already adhere.

Mutual Fund Seed Capital. In launching a new mutual fund, an investment adviser typically provides the necessary seed capital. In exchange for its investment, the adviser receives shares of the mutual fund, usually for a temporary period until the fund gets off the ground. For an investment adviser subject to Section 619 (either because it controls a depository institution, is a subsidiary of a bank holding company or of a company that controls an insured depository institution, or is designated as systemically significant and thus subject to supervision by the Federal Reserve), this acquisition of fund shares might inadvertently constitute "proprietary trading." While it is possible that the adviser's acquisition of fund shares could be viewed as a transaction "in connection with or in facilitation of customer relationships," the scope of this exclusion from the definition of proprietary trading is not yet known.

The legislation currently contemplates a study by the Financial Stability Oversight Council that would include the Council's recommendations for any modifications to the "definitions, prohibitions, requirements and limitations" in Section 619 that would "more effectively implement the purposes of this section." Implementing rules by the federal banking agencies and the Federal Reserve would be required to reflect the Council's recommendations. We believe that these provisions, as currently drafted, would provide regulators with sufficient authority to prevent any unintended consequences for mutual funds and their investors, including those identified above. In this regard, we would appreciate your assistance in ensuring that the legislative record clearly expresses the Committee's view that, in implementing the provisions of Section 619, regulators *should* prevent any unintended consequences for mutual funds and their investors.

We appreciate the difficulty involved in drafting this comprehensive reform legislation and look forward to continuing to work with you as the legislative process progresses.

Sincerely,

A handwritten signature in black ink, appearing to read "Paul Schott Stevens", with a long horizontal flourish extending to the right.

Paul Schott Stevens
President & CEO
Investment Company Institute

CC: Members of the U.S. Senate Committee on Banking, Housing & Urban Affairs