

RESERVE BANK OF AUSTRALIA



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G.R. Stevens
GOVERNOR

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Dr Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th and C Streets, NW
WASHINGTON DC 20551
USA

Dear Chairman Bernanke,

I would like to raise some concerns I have with aspects of the Proposed Rule for the implementation of Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule. In doing so, I recognise the challenges faced by the Federal Reserve and the other US agencies in implementing the legislation. It is clearly a significant and complex task.

I also acknowledge, and share, the desire of Congress and the US authorities to reduce the likelihood of discretionary investment activity by banking organisations threatening the stability of the US financial system. However, given the interconnectedness of global financial markets and the importance of US financial institutions in these markets, there is a risk that such measures will have unintended and undesirable spillover effects. This view is shared by a number of regulators, governments and financial market participants outside the United States.

I have concerns about the impact of the Proposed Rule on the liquidity and resilience of core funding markets outside the United States, including sovereign debt markets. In principle, banking organisations covered under the Proposed Rule are able to continue to undertake a range of transactions in financial markets, including market making, through a set of exemptions. However, the exemptions appear narrowly defined and there are uncertainties around their application. In addition, it appears likely banks will be subject to significant compliance costs. Taken together, this would seem to raise the risk of an unwarranted reduction in these activities by these institutions, particularly in foreign markets.

The extraterritorial reach of the Proposed Rule is a particular cause for concern. It raises the possibility of non-US banks that are active participants in their home debt markets limiting such activity because of their US operations, even if those US operations are minor. It is not clear that this will be the final outcome but if it were, such a development would have adverse consequences for the functioning of important markets outside the United States.

I note that the legislation explicitly exempts major US government debt markets from the prohibition on proprietary trading. The rationale put forward for this exemption must surely hold for government debt markets elsewhere. Therefore, it would seem sensible to extend the exemption for trading in US government debt markets to equivalent markets in other jurisdictions. I would urge the relevant agencies to consider such an amendment to the Proposed Rule.

More generally, the application of the rules appears too broad, in that they capture the global operations of all non-US banks with US operations, including the operations of their affiliates, subsidiaries and the funds they sponsor or invest in around the world. While exemptions exist for transactions conducted outside the United States, again, the exemptions are narrowly defined in many cases and will involve a significant compliance burden.

The extraterritorial reach of the Proposed Rule also raises important issues of regulatory oversight. The rules might give regulatory primacy to the US authorities, over the non-US operations of non-US banks. This raises issues of regulatory sovereignty, the risk of duplicative or inconsistent regulations, and excessive compliance burdens. From this perspective, the Proposed Rule contrasts with the broader global approach to regulatory reform undertaken to date.

The Federal Reserve and the other US agencies have an unenviable task in delivering the rulemaking for Section 619 of the Dodd-Frank Act. The focus of the legislation on US banks and the US financial system is understandable. However, given the importance of US financial institutions in global financial markets and the interconnectedness of markets and market participants, there have been concerns for some time about possible spillover effects of the legislation on non-US banks and on financial markets outside the United States. The release of the Proposed Rule for this legislation has not allayed these concerns and I would hope that the views of regulators and market participants from other jurisdictions will help to inform the review process over coming months.

Yours sincerely,



cc. Mr Daniel K. Tarullo