CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
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Board of Governors of the Federal
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Vanessa Countryman
Secretary
Securities and Exchange Commission
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Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

To Whom It May Concern:

The U.S. Chamber of Commerce's ("the Chamber") Center for Capital Markets Competitiveness appreciates the opportunity to comment on the interagency "Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" (the "Proposed Revisions") issued on January 30th, 2020.

Section 619 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") amended the Bank Holding Company Act ("BHCA") to institute a ban on short-term, speculative trading as well as ownership interests in certain private funds by covered banking entities. The Dodd-Frank Act tasked five federal financial regulators with implementing Section 619: the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively the "Agencies"). The original regulation implementing Section 619, commonly referred to as the "Volcker Rule," was issued in December of 2013 and ran over 900 pages long.[1]

The Chamber opposed the addition of Section 619 to the Dodd-Frank Act and we continue to believe that the Volcker Rule has far-reaching, negative consequences for the financial markets and broader economy. As discussed in the Chamber's previous comment letters on the Volcker Rule, the rule was always likely to create unnecessarily complex compliance burdens, restrict the ability of businesses to enter the debt and equity markets, and do little to promote the stability and resiliency of the financial system. Regrettably, many of these predictions came to fruition, with a 2017 report from the Treasury Department noting that the Volcker Rule "has spawned an extraordinarily complex and burdensome compliance regime" that "has hindered both market-making functions necessary to ensure a healthy level of market liquidity and hedging necessary to mitigate risk."[2]

The Chamber strongly supported reforms finalized in 2019 that tailored compliance obligations based on a banking entity's size and simplified some of the Volcker Rule's proprietary trading provisions. The Proposed Revisions would make changes to the "covered fund" provisions of the Volcker Rule, which regulate the types of private investment funds that banks may sponsor or maintain an ownership interest in. Evidence shows that the covered fund provisions of the Volcker Rule are depriving many areas of the country from the capital investment necessary to fuel growth and job creation. To highlight just one example, the Renaissance Venture Capital Fund estimates that the Volcker Rule has cost the state of Michigan alone $800 million in capital for emerging companies.[3] As the Agencies note, the proposed changes for covered funds could "allow banking entities with a presence in and knowledge of the areas where venture capital and

[1] 79 Fed. Reg. 5535 (Jan. 31, 2014).
[2] U.S. Treasury Department: "A Financial System that Creates Economic Opportunities: Banks and Credit Unions" Pursuant to Executive Order 13772 (June 2017).
[3] See comment letter for 2018 proposed revisions of the Volcker Rule from Bobby Franklin, CEO of the National Venture Capital Association (October 17, 2018) Available at https://www.sec.gov/comments/s7-14-18/s71418-4534624-176093.pdf

other types of financing are less readily available to businesses to provide this type of financing in those areas."[4]

The Chamber supports many of the amendments included in the Proposed Revisions. Further changes to the Volcker Rule are necessary to mitigate any further impact it may have upon business formation, economic growth, and the functioning of our debt and equity markets. While the Chamber continues to disagree with the underlying premise of the Volcker Rule, it is worth noting that no aspect of the Proposed Revisions would implicate the type of short-term trading that the rule was intended to prohibit. The Proposed Revisions would facilitate investment by banks in *long-term* investment vehicles and provide greater certainty for covered entities regarding compliance. We strongly disagree with any assertion that the Proposed Revisions would "gut" the Volcker rule or put our financial system at greater risk. These criticisms are based solely on conjecture and ignore several years' worth of evidence demonstrating the harm that the Volcker Rule has already created.

The Chamber supports many facets of the Proposed Revisions, including an exemption for certain credit funds, venture capital funds, and foreign public funds from the definition of a "covered fund" under the Volcker Rule. However, we believe some changes to the Proposed Revisions are necessary for these reforms to achieve their full potential. As the Agencies move forward with this important initiative, the Chamber makes the following recommendations, discussed in greater detail below:

1. **The Agencies should expand the exclusion from the covered fund definition to include long-term investment funds that meet the criteria outlined in Question 50 of the Proposed Revisions;**
2. **Credit funds eligible for an exclusion from the covered fund definition under the Proposed Revisions should not be subject to quantitative limits on the amount they can invest in equity securities or rights to acquire equity securities, but if the Agencies decide to require such quantitative limits, they should be set at 20% for non-qualifying assets;**
3. **The definition of "venture capital fund" should reflect investment structures that may not meet the narrow definition adopted pursuant to Title IV of the Dodd-Frank Act;**
4. **The exclusion for foreign public funds should be fully aligned with the exclusion for U.S. registered investment companies (RICs); and**

[4] Proposed Revisions at 70.

5. **The agencies should maintain a loan securitization exclusion that is distinct from the credit fund exclusion and allow loan securitization issuers to hold up to 10% of assets in non-loan assets.**

<u>Recommendations</u>

1. **<u>The Agencies should expand the exclusion from the covered fund definition to include long-term investment funds that meet the criteria outlined in Question 50 of the Proposed Revisions.</u>**

The text of Section 619 prohibits a banking entity from acquiring or retaining an ownership in, sponsoring, or having certain relationships with "hedge funds" and "private equity funds." When the Agencies promulgated the final Volcker Rule in 2013, they substituted these terms for the more expansive "covered fund" definition, which was established to prevent indirect evasion of the proprietary trading prohibition. However, the "covered fund" definition is far too broad and prohibits bank investment in long-term investment vehicles that don't engage in the type of short-term trading activity that Volcker was intended to prevent.

The Proposed Revisions would exclude certain credit funds and qualifying venture capital funds from the definition of a covered fund and make changes to the exclusion for foreign public funds. A credit fund would be eligible for exclusion if its assets consisted solely of loans, debt instruments, rights related to acquiring, holding, or servicing loans or debt instruments, and certain foreign exchange interest rate derivatives. A venture capital fund that meets the SEC definition under 17 CFR § 275.203(l) (as adopted pursuant to Title IV of the Dodd-Frank Act) would also be excluded.

In addition to the exclusions for qualifying credit funds and venture capital funds, we believe the Agencies should also exclude from the covered fund definition certain qualifying long-term investment funds that are critical to our economy. In order to qualify for such an exclusion, we would support the conditions that are set forth in Question 50 of the Proposed Revisions. Question 50 inquires whether an exclusion from the covered fund definition is appropriate for funds that: 1) make long-term investments that a banking entity could make directly; 2) hold themselves out as entities or arrangements that make investments intended to be held for a set minimum time period, such as two years; 3) whose relevant offering and governing documents reflect a long-term investment strategy; and 4) that meet all the other requirements of the proposed qualifying venture capital exclusion, but for the fact that they do not fall under the definition included in 17 CFR § 275.203(l).

During deliberations over the Dodd-Frank Act in Congress, a colloquy between Senators Jeff Merkley and Carl Levin – the primary drafters of Section 619 - illuminates the true purpose of the Volcker Rule. As Senator Merkley stated:

> *"While the intent of Section 619 is to restore the purpose of the Glass-Steagall barrier between commercial and investment banks, we also update that barrier to reflect the modern financial world….<u>Section 619 seeks to reorient the U.S. banking system away from leveraged short-term speculation and toward the safe and sound provision of long-term credit to families and business enterprises.</u>"*

A fund meeting the four conditions outlined in Question 50 could not be described as promoting the type of "leveraged short-term speculation" that Senator Merkley and other supporters of Section 619 were concerned about. In fact, funds that meet these four conditions – including many private equity funds - by and large facilitate the "safe and sound provision of long-term credit to families and business enterprises." There is little reason to prohibit banks from investing in these types of investment vehicles.

There is also no sound policy rationale for prohibiting a banking entity from making indirect investments in a company (e.g. via a third-party sponsored fund) that the bank could make directly (e.g. through the extension of credit or merchant banking activities). We believe that final regulations adopted by the Agencies should make it easier for banking entities to invest in third-party sponsored funds that make long-term investments.

2. **<u>Credit funds eligible for an exemption under the Proposed Revisions should not be subject to quantitative limits on the amount they can invest in equity securities or rights to acquire equity securities,</u> but if the Agencies decide to require such quantitative limits, they should be set at 20% for non-qualifying assets.**

Under the Proposed Revisions, certain credit funds would be excluded from the definition of a covered fund, so long as the issuer held assets consisting solely of:

- Loans;
- Debt instruments;
- Related rights and other assets that are related or incidental to acquiring, holding, servicing, or selling loans, or debt instruments; and
- Certain interest rate or foreign exchange derivatives.

In order to comply with the exclusion, any rights or assets related to loans or debt instruments held by the credit fund would have to be cash equivalents, securities received in lieu of certain debts, or certain equity securities (or rights to acquire equity securities) received on customary terms in connection with the credit fund's loan or debt holdings.

As the Proposed Revisions note, there may be instances where a banking entity receives a warrant or option issued by a borrower – thus allowing the bank to share in the profits and income of the borrower – in lieu of interest payments or to reduce the overall interest paid by a borrower. The Agencies therefore believe that excluded credit funds should be eligible to hold equity securities (or rights to acquire securities) but have not proposed a specific quantitative limit on how much an issuer could hold.

While we understand the Agencies are considering adopting quantitative limits in rulemaking, we do not believe such limits are necessary given other protections and restrictions included in the Proposed Revisions. For example, in order to be eligible for the credit fund exclusion, issuers would have to actually be engaged in providing credit and credit intermediation. Section 13 of the BHCA also includes anti-evasion provisions that prevents issues from circumventing the requirements necessary for an exclusion.

There are also general guidelines under the Proposed Revisions that prohibit a credit fund from engaging in activities that constitute proprietary trading and from issuing asset-backed securities. For these reasons, we do not believe that arbitrary limits for the amount of equity securities a fund could hold are necessary and could lead to unintended consequences.

3. **<u>The definition of "venture capital fund" should reflect investment structures that may not meet the narrow definition adopted pursuant to Title IV of the Dodd-Frank Act.</u>**

It is abundantly clear from the Congressional record that Congress never intended to include venture capital funds as part of the prohibitions included in Section 619. Then-Senator Chris Dodd of Connecticut stated on the Senate floor:

> *"The purpose of the Volcker rule is to eliminate excessive risk-taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason. <u>But properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by</u>*

> *the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J).”*[5]

A recent study out of Stanford University found that VC-backed public companies in the United States employ roughly four million people constitute one-fifth of the market capitalization of the U.S. equity market. The study also found that VC-backed firms play an outsize role in research and development (R&D), accounted for $115 billion in R&D spending in 2013, which is 44% of all R&D spending in the United States.[6] Venture capital is a critical source of financing for innovative businesses that helps them grow from small to large.

The Chamber therefore strongly supports an exclusion for venture capital funds from the covered fund definition, which is consistent with Congressional intent and will allow banking entities to invest in these important long-term growth vehicles. However, we are concerned that the Proposed Revisions rely on an overly narrow definition of a “venture capital fund” that was adopted by the SEC in 2011 pursuant to Title IV of the Dodd-Frank Act.[7] That definition excludes shares of emerging growth companies (EGCs) from being classified as “qualifying investments,” thereby discouraging venture capital investments in EGCs. As the Chamber and seven organizations explained in a 2018 report:

> *Registered Investment Adviser (RIA) rules promulgated by the SEC inadvertently discourage some venture capital firms from investing in EGCs. The 2010 Dodd-Frank Act sought to exempt venture capital funds from the costs and challenges associated with becoming an RIA. However, the definition of “venture capital fund” promulgated by the SEC in Rule 203(1)-1 of the Investment Advisers Act was too narrow and did not meet the Dodd-Frank statutory obligations of a full venture capital exemption. The current definition ignores critical elements and developments related to the venture capital industry, including growth equity firms which can often be investors in EGCs around the time they are considering a public offering. Shares of EGCs, including the purchase of EGC shares on the secondary*

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[5] 156 Cong. Rec. S5904-S5905 – Colloquy between Senators Chris Dodd and Barbara Boxer (July 15th, 2010).

[6] Role of Venture Capital in the Economic Growth of the United States (June 10, 2019). https://medium.com/@abc_40376/role-of-venture-capital-in-the-economic-growth-of-united-states-11b2090330a1

[7] Release No. IA-3222, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39645 (July 6, 2011).

market, should be considered qualifying investments. Creating a more accurate venture capital exemption definition will expand the pool of possible investors for EGCs.[8]

The Proposed Revisions are also not reflective of certain companies that operate as venture investors and are exempt from having to register as an investment company but may not meet the technical definition of a venture capital fund under SEC rules. For example, certain technology companies and startup incubators are formed to make early-stage investments in businesses that are held for a long period of time, but under the Proposed Revisions banks would be prohibited from investing in such entities. We believe that the final regulations should reflect the evolving nature of the venture capital industry and not rely solely on the existing SEC definition.

4. **The exclusion for foreign public funds should be aligned with the exclusion for U.S. registered investment companies (RICs)**

The existing Volcker Rule excludes from the covered fund definition a foreign public fund that is offered to retail investors in the fund's home jurisdiction, and which is sold "predominately" through public offerings outside the United States. ("Predominantly" meaning that 85% of the fund's ownership is sold to non-U.S. retail investors.)

The Proposed Revisions would change the existing foreign public fund exclusion so that it is more closely aligned with the exclusion for U.S. registered investment companies (RICs). The Proposed Revisions would eliminate the "predominantly" sold requirement as a threshold for public offerings outside the United States, as well as the requirement that a foreign public fund be sold to retail investors in the home country of the fund.

While the proposed changes are an improvement over the status quo, there would still be significant differences between the manner in which foreign public funds and RICs are treated. For example, a RIC would be treated as a banking entity if they are sponsored by a bank that holds 25% or more of its voting securities after a seeding period. For foreign public funds, that number is 15%. Foreign public funds would also have to count senior officers, directors, and affiliates towards that threshold, a requirement that does not exist for RICs.

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[8] U.S. Chamber, Securities Industry and Financial Markets Association, American Securities Association, Equity Dealers of America, Biotechnology Innovation Organization, National Venture Capital Association, TechNet, Nasdaq: "Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public" (April 2018).

These additional requirements for foreign public funds are inconsistent with the Agencies' stated objective under the 2013 rulemaking to "treat foreign public funds consistently with similar U.S. funds to limit the extraterritorial impact of section 13 of the BHC Act." The Chamber reiterates its position that the Agencies should amend the existing exclusion for foreign public funds to align it completely with the exclusion for U.S. retail funds.

5. The agencies should maintain a loan securitization exclusion that is distinct from the credit fund exclusion and allow loan securitization issuers to hold up to 10% of assets in non-loan assets.

The current Volcker Rule provides an exclusion for issuers of asset-backed securities whose assets consist of loans or other qualifying assets including cash equivalents, certain rate or foreign exchange derivatives, servicing assets, interests in a tax subsidiary or similar entity, and assets acquired by the issuer in a workout or foreclosure.

The text of Dodd-Frank states that nothing under Section 619 should "be construed to limit or restrict the ability of a banking entity…to sell or securitize loans in a manner otherwise permitted by law." Notwithstanding this clear direction from the Congress, the 2013 rulemaking imposed severe limits upon the ability of banks to participate in the securitization market.

The prohibition against holding non-loan assets in particular has caused a number of banking entities to divest, limit, or restructure their holdings in loan securitizations. The Agencies have previously sought comment as to whether a loan securitization should be permitted to hold up to 5 or 10% of its assets in non-loans.[9]

The Chamber supports setting the threshold for non-loan assets at a minimum of 10% of all assets for loan securitizations, which we believe will provide ample flexibility for certain funds that contain "bond buckets." Given the unique nature of the securitization market relative to long-term credit funds, we also support maintaining an exclusion for loan securitizations that is separate and distinct from the exclusion for credit funds under the Proposed Revisions.

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[9] 83 Fed. Reg. at 33,480.

Other considerations

Seeding Period

Under the current Volcker Rule, seeding vehicles for funds that are excluded from the covered fund definition – including RICs, foreign public funds, and business development companies (BDCs) – are also excluded from the definition. The Agencies issued a set of frequently asked questions (FAQs) in 2015 that acknowledged the seeding period for such funds could in some instances last up to three years, and that the Agencies would grant flexibility in their determination as to whether an RIC, foreign public fund, or BDC should be treated as a banking entity. We believe that this three-year period should be codified by the Agencies in a final regulation.

Conclusion

We appreciate the Agencies' continued work to reform the Volcker Rule. We believe that changes can be made to the rule that will reduce compliance burdens and facilitate investment without compromising the safety and soundness of banking entities. We stand ready to work with the Agencies in this effort.

Sincerely,

[redacted]

Tom Quaadman