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Comments on OCC Docket No. OCC-2011-14; FRB Docket No. R-1432 and RIN 7100 AD 82; FDIC RIN 3064–AD85; SEC File No. S7–41–11:
Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Dear Ladies and Gentlemen:

This letter is respectfully submitted by BVI Bundesverband Investment und Asset Management ("BVI") in response to a request by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, U.S. Securities and Exchange Commission ("SEC", collectively, the "Agencies") for comments regarding the above-referenced releases, which propose rules to implement

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Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule (the "proposed rules").[1]

BVI is the representative trade association for the investment fund and asset management industry in Germany. Founded in 1970, BVI represents today 82 members who handle assets of EUR 1.8 trillion in both investment funds and individual accounts. BVI`s members directly and indirectly manage the capital of 50 million private clients in 21 million households. BVI members comprise fund and asset management companies of different sizes who offer their services in the German and European market.

As a member of EFAMA the European Fund and Asset Management Association, BVI fully endorses the positions submitted on behalf of EFAMA. The following comments are meant to reiterate and highlight the major requests while paying particular regard to the characteristics of the German asset management industry.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

BVI would like to thank the Agencies for giving representatives of non-U.S. industry the opportunity to comment on the proposed rules. In these terms, BVI is committed to making suggestions for developing a regulatory framework that both is consistent with the mandates set forth by the U.S. Congress in the Volcker Rule and effectively protects the safety and soundness of banking entities and the stability of the U.S. financial system, while at the same time not unnecessarily restricting or burdening business and conduct outside the United States that does not in any meaningful way pose a threat to the stability of the U.S. financial system.

BVI recognizes the challenges the Agencies face in implementing the Volcker Rule and the need to prevent banking entities in the United States from seeking to circumvent the requirements of the Volcker Rule by choosing to conduct otherwise prohibited activities outside of the United States. **We believe, however, that, in their current form, the proposed rules represent an inappropriate extraterritorial application of United States jurisdiction and significantly exacerbate the negative impact that the**

[1] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (Nov. 7, 2011) [hereinafter the "Proposing Releases"].

Volcker Rule will have on the European fund and asset management industry without measurably furthering the purpose or intent of the Volcker Rule.

Under the proposed rules, a European or otherwise non-U.S. fund manager qualifying as a banking entity due to its group structure would be effectively prohibited from engaging in its primary business activity which is the provision of management services to investment funds. Save the very limited possibility to rely on any exception for permitted fund activities, he would be banned from selecting or controlling (or having employees who constitute) a majority of management of a covered fund and from sharing with a covered fund the same name or a variation of the same name. Moreover, due to the potential classification of all non-U.S. investment funds as covered funds for the purpose of the proposed rules, banking entities established within or outside the United States could be barred from investing in such funds. As a result, European banks as well as insurance companies and other undertakings belonging to banking groups might be deprived of the ability to invest in regulated and supervised European funds and required to disinvest from such funds in general. It goes without saying that such interpretation of the rules would bring severe impediments and cause major disruptions to the non-U.S. markets for investment funds.

We are convinced that these problems can be avoided, or at least substantially mitigated, without sacrificing the objectives of the Volcker Rule, through targeted revisions to the proposed rules to clarify the application of several provisions and to tailor the scope of other provisions that in our view are over-inclusive and unfair to non-U.S. funds and their asset managers and other service providers.

In this regard, BVI recommends that the Agencies:

1. **Revise the definition of "covered fund" so that non-U.S. regulated funds[2] are treated similarly to their U.S. counterparts, i.e., mutual funds and other investment companies that are registered with the SEC under the Investment Company Act of 1940 (the "1940 Act") or are not required to register without relying on Sections 3(c)(1) or 3(c)(7) of the 1940 Act;**

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[2] Throughout this letter, references to "non-U.S. regulated funds" are intended to capture funds that are organized outside of the United States and are subject to investment fund regulation under the laws of a country other than the United States.

The proposed rules define covered funds to include not only hedge funds and private equity funds that actually rely on section 3(c)(1) or 3(c)(7) of the 1940 Act to avoid investment company status, but also investment funds that are organized outside the United States and not offered to U.S. investors, but would be covered funds if offered to U.S. residents. The extent of this definition is such that, absent clarification, it could result in every regulated fund outside the United States being considered a covered fund, even though the intent is presumably only to capture traditional non-U.S. hedge funds and private equity funds.

2. **Clarify and, if necessary, broaden the scope of the "solely outside of the United States" exception for covered fund activities to conform to industry norms and market practices as reflected in Regulation S under the Securities Act of 1933 (the "1933 Act") to better reflect the Congressional intent to limit the extraterritorial impact of the Volcker Rule's provisions;**

As proposed, the "solely outside of the United States" exception is so narrowly drawn that it is unlikely to be available to many non-U.S. banking entities' covered funds activities even though they take place "outside the United States" as this concept has been widely understood for years for purposes of the U.S. securities law. Moreover, many non-U.S. covered funds have no practical means to identify their ultimate investors if their units or shares are issued as bearer instruments and offered to the public via multiple distribution channels.

3. **Clarify that non-U.S. regulated funds that qualify for the "solely outside of the United States" exception from the Volcker Rule's restrictions on covered fund activities (i) should not be considered "banking entities" and (ii) should not be subject to the "Super 23A" restrictions under section ___.16 of the proposed rules.**

Whereas covered funds that qualify for the sponsored fund exception are excluded from the definition of a banking entity, covered funds that qualify for the "solely outside of the United States" exception are not. This appears to be solely an unintended consequence of the proposed rules and not reflective of any intent to limit the ability of such covered funds to engage in proprietary trading and, accordingly, should be corrected in the final rules. Another apparent unintended consequence of the proposed rules is the potential extraterritorial application of the Super 23A prohibitions to covered funds that are managed by a banking entity relying on the solely outside of the United States exception. In the absence of relief, the covered fund that has the least connection with the United States could be subject to the harshest restrictions without any policy justifications for such a result.

DETAILED DISCUSSION OF SPECIFIC COMMENTS AND RECOMMENDATIONS

1. The Agencies Should Revise the Definition of "Covered Fund" to Exclude Non-U.S. Regulated Funds to the Same Extent as their U.S. Counterparts.[3]

BVI's greatest concern with the proposed rules is the potentially unequal treatment of U.S. registered investment companies, on the one hand, and UCITS[4] and other regulated investment funds available to European investors, on the other. As discussed in greater detail below, U.S. registered investment companies are not considered to be covered funds under the proposed rules, while their regulated non-U.S. counterparts appear to be treated as covered funds. Accordingly, under the proposed rules, banking entities may sponsor and invest in U.S. registered investment companies largely without limitation, but would be prohibited from equivalent activities involving UCITS and other non-U.S. regulated funds.

Analysis of the Problems

The Volcker Rule seeks to restrict a banking entity's relationships with "hedge funds" and "private equity funds" each of which terms is defined by the statute as an issuer that would be an investment company as defined in

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[3] Reference is made to Questions 217, 221, 223, 224, and 225 of the Proposing Releases.

[4] UCITS, or "undertakings for collective investment in transferable securities," are collective investment schemes established and authorized under a harmonized European Union ("EU") legal framework, currently EU Directive 2009/65/EC, as amended, under which a UCITS established and authorized in one EU Member State ("Member State") can be sold cross border into other EU Member States without a requirement for an additional full registration. This so-called "European passport" is central to the UCITS product and enables fund promoters to create a single product for the entire EU rather than having to establish an investment fund product on a jurisdiction by jurisdiction basis.

the 1940 Act but for section 3(c)(1) or 3(c)(7) of the 1940 Act, or such similar funds as the Agencies may determine in the implementing regulations.[5] Implicitly excluded from this definition are issuers that are registered with the SEC under the 1940 Act as investment companies or are able to rely on other exceptions under the 1940 Act to avoid investment company status.

Through the use of the “similar funds” authority, the proposed rules expand the term “covered fund” to “any issuer . . . that is organized or offered outside of the United States that would be a covered fund . . . were it organized or offered under the law, or offered to one or more residents, of the United States or of one or more States.”[6] U.S. registered investment companies, and other issuers that are able to rely on exceptions other than section 3(c)(1) or 3(c)(7) to avoid investment company status, are excluded from the definition of covered fund.[7]

This proposed supplement to the definition of “covered fund” is the primary source of concern for non-U.S. fund managers. **The very broad phrasing of this portion of the definition arguably encompasses not only non-U.S. hedge and private equity funds but also most non-U.S. regulated funds, including UCITS and other European regulated funds**, because, were they to offer ownership interests to U.S residents, they could be considered investment companies but for section 3(c)(1) or 3(c)(7).

No policy reason or justification for the unequal treatment of U.S. registered investment companies and their counterparts elsewhere in the world is offered in the proposed rules. As a result, we believe that this may simply be an unintended consequence of the Agencies’ attempts to prevent banking entities from circumventing the Volcker Rule’s restrictions by moving their activities offshore.

In any case, the rationale supporting the exclusion of registered investment companies from the covered fund status is equally applicable to non-U.S. regulated funds, such as UCITS and other European regulated funds. Like U.S. registered investment companies, non-U.S. regulated funds are subject to regulation regarding the manner in which they are managed, the securities and financial instruments in which they may invest and the means by

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[5] *See* 12 U.S.C. § 1851(h)(2).

[6] *See* Section ___.10(b)(1)(iii) of the proposed rules.

[7] *See* notes 71 and 222 to the Agency Proposing Release, notes 76 and 228 of the CFTC Proposing Release and accompanying text.

which interests in the funds may be offered to investors. Moreover, the statutory definition of hedge fund and private equity fund in the Volcker Rule itself arguably would not include non-U.S. regulated funds.[8] Still, the proposed rules greatly broaden the scope of the Volcker Rule by including non-U.S. regulated funds within the meaning of "covered fund," despite the fact that non-U.S. regulated funds are comparable to U.S. mutual funds in all material respects. **If the proposed rules are not revised, the Volcker Rule would be applied more restrictively, and to a larger group of funds, outside of the United States than within it.**

In addition to greatly broadening the original scope of the Volcker Rule, including non-U.S. regulated funds in the definition of "covered fund" could cause conflicts with legal requirements in other jurisdictions, and would clearly conflict with market practice, which would effectively preclude many foreign banking entities from organizing and offering non-U.S. regulated funds in such jurisdictions. In this respect, the primary exception under the proposed rules for covered fund activities is the so-called "sponsored fund exception," [9] to qualify for which a covered banking entity must satisfy a lengthy set of conditions. While many of the conditions would not be objectionable to non-U.S. regulated funds, two in particular are very problematic.

First, under the sponsored fund exception, a covered fund may not share the same or a similar name as the banking entity or an affiliate or subsidiary of the banking entity.[10] However, in Germany it is common practice to disclose the designation of the sponsoring investment manager in the fund name in order to provide full transparency to investors. Other European jurisdictions even require a fund to have a name that has a direct connection with its

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8 Consistent with statements of the SEC in regard to the treatment of non-U.S. funds, it would be reasonable to conclude that a non-U.S. regulated fund is simply outside of the potential application of the registration provisions of the 1940 Act, and therefore would not be viewed as an investment company that would need to avail itself of the exemptions contained in sections 3(c)(1) or 3(c)(7) of the 1940 Act to avoid registration in the U.S. under the 1940 Act. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 at n.294 and accompanying text (June 22, 2011) [hereinafter "Advisers Release"] (stating, "a non-U.S. fund is a [pooled investment vehicle that is excluded from the definition of 'investment company' under the 1940 Act by reason of Section 3(c)(1) or 3(c)(7)] if it makes use of U.S. jurisdictional means to, directly or indirectly, offer or sell any security of which it is the issuer and relies on either section 3(c)(1) or 3(c)(7)").

9 *See* Section ___.11.

10 Section ___.11(f)(1).

sponsor.[11] In such a case, a banking entity subject to the Volcker Rule would be precluded from organizing and offering a covered fund in that jurisdiction because it would not be able to comply with both the Volcker Rule and the local requirements.

Second, the proposed rules also prohibit any director or employee of a banking entity from investing in a covered fund offered or organized by the banking entity.[12] However, many European regulated funds issue their securities as bearer instruments which do not require any registration of the ultimate investors. Since these funds are typically offered to the public via multiple distribution channels, compliance with this condition would be virtually impossible to ensure. Moreover, European law is meant to require certain fund managers to structure remuneration of their senior management, risk takers, control functions and other comparable employee categories in a manner ensuring that <u>at least 50 percent of the variable remuneration consists of ownership interests in the managed funds</u>.[13] The rationale behind this requirement is to achieve a stronger alignment between the interests of investment funds and persons taking key responsibilities in their management. As a further step, it is already envisaged to extend these remuneration standards to the management of UCITS, thus covering all types of European regulated and non-regulated funds. The paradoxical consequence would be that a conduct which is explicitly required under EU legislation for investment funds would be prohibited for banking entities wishing to sponsor an investment fund under U.S. law.

Recommendations to Address the Problems

Accordingly, in keeping with the purpose and intent of the Volcker Rule, we recommend that the definition of “covered fund” in the proposed regulations be revised to exclude non-U.S. regulated funds, which should be defined to mean funds that are located outside of the United States, make offerings of their securities in a country other than the United States, and are subject to regulation as collective investment undertakings under the laws of a country other than the United States.

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[11] This is notably the position of the UK FSA.

[12] Section ___.11(g).

[13] *See* Annex II para. 1(m) of Directive 2011/61/EU of the European Parliament and the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD) which is due for transposition and entry into force by 21 July 2013.

We recognize that different countries take different approaches to regulation of investment funds offered to their residents. There is nothing in the Volcker Rule, however, to suggest that substantive equivalence of an investment fund's home country regulation with that of the 1940 Act is necessary, nor is there any policy reason to require such equivalence, in order to be accorded comparable relief from the Volcker Rule's restrictions. The critical determinant should be simply whether the home country subjects the fund to regulation, because the hallmark of hedge funds and private equity funds is that they are not subject to regulation.

While publicly offered retail investment funds, which would include UCITS and other nationally regulated investment funds, are mostly like U.S. registered investment companies and clearly should be excluded from the definition of covered fund, there are many other types of non-U.S. regulated funds that similarly should not be treated as covered funds. From the German perspective, an important example is the German *Spezialfonds* representing investment funds designed specifically for institutional investors and subject to product regulation in close alignment with the UCITS regime. German *Spezialfonds* may have solely legal persons as investors and, accordingly, are not distributed to the public. Such funds are analogous to so-called "1940 Act only" funds offered to institutional investors in the United States. "1940 Act only" funds are not deemed covered funds under the proposed regulations, and their non-U.S. counterparts should be treated in a similar manner.

We strongly believe that the recommended changes are entirely consistent with the purpose and intent of the Volcker Rule and will not pose risks to the safety or soundness of any banking entity or to the interests of the United States. Nonetheless, in the event that it were determined that a non-U.S. regulated fund or group or type of non-U.S. regulated funds posed inappropriate risks, the proposed rules contain provisions that empower the Agencies to place limitations on a covered banking entity's activities with such funds, regardless of whether these activities are otherwise permitted by the proposed rules.[14] In light of this residual authority, among other reasons, we believe it would be inappropriate to subject all non-U.S. regulated funds to

[14] These limits restrict covered fund activities with respect to transactions or activities that would "result, directly or indirectly, in a material exposure by the covered banking entity to a high-risk asset or a high-risk trading activity" or would "[p]ose a threat to the safety and soundness of the covered banking entity or the financial stability of the United States." *See* Section ___.17(a)(2)-(3).

restrictions that were designed to apply to funds that are similar to hedge funds or private equity funds. Such an overly restrictive approach would be unduly harmful to a large number of entities with no apparent benefit to banking entities or the interests of the United States.

2. The Agencies Should Clarify, and If Necessary Broaden, the Scope of the Exception for Covered Fund Activities Outside the United States to Better Reflect the Congressional Intent to Limit the Extraterritorial Impact of the Volcker Rule.[15]

In recognition of the potential negative consequences of applying its provisions extra-territorially, the Volcker Rule includes an exception for certain covered fund activities outside of the United States.[16] Qualifying non-U.S. covered banking entities[17] that are not controlled directly or indirectly by a U.S. banking entity are permitted to rely on this exception.[18] In order for the qualifying non-U.S. banking entity to sponsor or acquire an ownership interest in a covered fund in reliance on this authority, however, no ownership interest may be offered or sold to a "resident of the United States", and the covered banking entity's activities must occur "solely outside of the United States."[19] The proposed rules provide that an activity shall be considered to occur solely outside of the United States only if (i) the banking entity involved in the activity is not organized under U.S. law, (ii) no affiliate or employee of the banking entity that is involved in distribution of the covered fund is incorporated or physically located in the United States, and (iii) no ownership interest is offered or sold to a U.S. resident.[20]

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[15] Reference is made to Questions 136, 138, 139, 140, 293, 294, and 295 in the Proposing Releases.

[16] Specifically, the Volcker Rule provides an exception for: The acquisition or retention of any equity, partnership, or other ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity . . . solely outside of the United States, provided that no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

12 U.S.C. § 1851(d)(1)(I).

[17] Qualifying non-U.S. banking entities are those that are able to rely on Sections 4(c)(9) or (13) of the Bank Holding Company Act of 1956 ("BHC Act") with respect to their non-U.S. covered fund activities. *See* Section ___.13(c)(1)(ii), (2).

[18] *See* Section ___.13(c)(1)(i).

[19] *See* Section ___.13(c)(1)(iii)-(iv).

[20] *See* Section ___.13(c)(3).

Analysis of the Problems

BVI believes that, despite the clear intent to limit the extra-territorial reach of the Volcker Rule, the conditions of this exception as stipulated by the proposed rules are so narrow that they are unlikely to be met by many non-U.S. banking entities' covered fund activities even though they clearly take place "outside the United States" as that concept has been widely understood for years for purposes of the U.S. securities laws. In this respect, the SEC's Regulation S[21] has since 1990 been the primary source of guidance as to whether securities transactions by non-U.S. issuers have sufficient contacts and effects in the United States to trigger the application of the U.S. securities laws. Significantly, Regulation S looks at the totality of a non-U.S. fund's offering, including not only whether U.S. investors acquire securities from the non-U.S. fund, but also whether the non-U.S. fund directly or indirectly is actively seeking to market its securities to U.S. investors, in order to determine whether the offering occurs outside the United States. By contrast, the proposed rules would deem a qualifying non-U.S. banking entity's non-U.S. covered fund activities to be ineligible for the solely outside of the United States exception if any affiliate or employee involved in the distribution of the non-U.S. covered fund's securities is organized or physically located in the United States, no matter how immaterial the involvement of the affiliate or employee to the covered fund activities.[22] Similarly, the qualifying non-U.S. banking entity's non-U.S. covered fund would be ineligible for this exception if any ownership interest is sold to a U.S. resident regardless whether such sale resulted from a deliberate effort to market the fund to U.S. investors or was outside the control of the qualifying non-U.S. banking entity.[23]

The more restrictive approach taken by the proposed rules will severely limit the covered fund activities of many European fund managers and other non-U.S. banking entities that otherwise would comply with Regulation S.

In particular, there is a substantial risk that non-U.S. regulated funds offered by non-U.S banking entities will not be able to rely on the exception due to the presence of a limited number of U.S. resident investors. This is partially due to the fact that the proposed rules' definition of a

[21] *See* 17 C.F.R. §§ 230.902-905.

[22] *See* Section ___.13(c)(3)(ii).

[23] *See* Section ___.13(c)(3)(iii).

"resident of the United States" is overly broad, especially in comparison to the Regulation S definition of "U.S. person". As recognized in the Proposing Releases, the proposed definition of resident of the United States is similar to, but broader than, the definition of U.S. person found in Regulation S under the Securities Act of 1933, as amended ("1933 Act").[24] The Agencies did not offer any justification, however, as to why they chose to use a different definition. Thus, even where a non-U.S. fund's procedures and offering documents carefully complied with Regulation S's limitations and no sales were made to U.S. persons, sales could have been made to investors that would be deemed U.S. residents under the proposed rules. In addition, where a non-U.S. investor in a non-U.S. fund moves to the United States, any new investments in such fund or exchanges of shares of another non-U.S. fund in the same fund family would be considered a "sale" to a U.S. resident, which would cause the non-U.S. regulated fund to lose its "solely outside of the United States" exception.[25]

As a result of the restrictive approach taken by the proposed rules in determining whether covered fund activities occur "solely outside of the United States", many non-U.S. banking entities that have carefully structured their non-U.S. fund operations to avoid marketing and sales of their non-U.S. funds to U.S. persons in full compliance with Regulation S will not be able to satisfy the requirements of the proposed rules without substantial changes to their operations.

Furthermore, the different treatment of discretionary accounts under Regulation S and the proposed rules could result in significant structural changes to the markets for certain non-U.S. covered funds. Under Regulation S, a discretionary account with a U.S. adviser held on behalf of a non-U.S. person is considered to be a non-U.S. person,[26] while the proposed rules would treat

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24 *See* CFTC Proposing Release, 77 Fed. Reg. at [__]; Agency Proposing Release, 76 Fed. Reg. at 68,881-82.

25 The definition of "sale" and "sell" in the proposed rules mirrors the definitions of those terms found in the 1933 Act and the Exchange Act of 1934. *See* Section ___.2(v). With respect to exchanges, courts have commonly found that "sale" or "sell" includes an exchange of a security of one company for a security of another company. *See* LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION, CH. 3A(2)(A) (Supp. 2011).

26 *See* 17 C.F.R. § 230.902(k)(2)(i). Regulation S also treats a discretionary account held on behalf of a U.S. person by a non-U.S. adviser to be a non-U.S. person. *See* Offshore Offers and Sales, Securities Act Release No. 6863 (Apr. 24, 1990) (stating that for purposes of Regulation S, an account is not a U.S. person "where a non-U.S. person makes investment decisions for the account of a U.S. person"). In addition to this, unlike Regulation S, which specifically excludes from being a "U.S. person" the

the discretionary account as a U.S. resident.[27] Accordingly, any non-U.S. covered fund, even a UCITS or other non-U.S. regulated fund, that is managed by a U.S. investment adviser or sub-adviser, potentially could be treated as a U.S. resident under the proposed rules, regardless of whether the non-U.S. fund has any U.S. investors, and could be prohibited from investing in a non-U.S. covered fund if the manager of such fund is relying on the solely outside of the United States exception. This means that U.S. investment advisers could be placed at a competitive disadvantage in offering non-U.S. funds that invest in other covered funds that are offered exclusively to non-U.S. investors because they may be denied the opportunity to invest in many of the available non-U.S. funds which are managed by non-U.S. banking entities. A relevant example could be a globally investing fund of funds managed by a U.S. investment adviser or sub-adviser. Conversely, non-U.S. banking entities that offer non-U.S. covered funds may be denied access to the investment capital of such funds of funds solely because they are managed by a U.S. investment adviser.

Recommendations to Address the Problems

For the above stated reasons, BVI believes that the Agencies should revisit the scope of the solely outside of the United States exception and revise the conditions imposed on qualifying non-U.S. banking entities in order to better accord with the Congressional intent to limit the extra-territorial impact of the Volcker Rule.

The best and most efficient way to achieve this would be to more closely align the conditions of the exception to the approach utilized by Regulation S. This would include at a minimum incorporating by reference the Regulation S definition of "U.S. person" into the "resident of the United States" definition. While the Proposing Releases suggest that having a similar definition to Regulation S "should promote consistency and understanding among market participants that have experience with the concept from

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"International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the United Nations, and their agencies, affiliates and pension plans, and any other similar international organizations, their agencies, affiliates and pension plans," the proposed rules could potentially consider such international entities to be "residents of the United States" as there is no similar exception in the proposed rules. 17 C.F.R. § 230.902(k)(2)(vi).

[27] *See* Section ___.2(t)(6)-(7).

the SEC's Regulation S",[28] we think that by adopting a definition that contains a number of critical differences from the Regulation S definition, the Agencies would create unnecessary confusion and would cast doubt on the ability of market participants to rely on the well-established body of law underlying the Regulation S definition.[29]

Moreover, the Agencies should revise the conditions of the solely outside of the United States exception to ensure that the presence of a limited number of U.S. resident investors in a non-U.S. covered fund does not disqualify the fund from relying on this exception unless the fund had actively marketed the fund's securities to U.S. investors.

It should also be taken into account that non-U.S. regulated funds are often publicly offered to retail investors via multiple distribution channels. Many of them issue securities in the form of bearer instruments which do not require disclosing the identity of the ultimate investor. In addition, fund units issued as bearer instruments are freely negotiable on capital markets and can be purchased and sold without knowledge of the fund or its manager. Consequently, non-U.S. regulated funds are often not in the position to determine whether and how many U.S. residents they have as investors which would per se deprive them of the possibility to rely on the solely outside of the United States exception.

Therefore, the Agencies should consider adopting a "reasonable belief" approach with regard to the existence or non-existence of U.S. investors in non-U.S. regulated funds on terms equivalent to those recognized for the purpose of the Investment Adviser Registration under section 202(a)(30) of the Investment Advisers Act.[30] Such approach would ensure that a fund which takes appropriate steps in order to prevent offering to U.S. residents (e.g. through a respective disclaimer in the fund

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[28] CFTC Proposing Release, 77 Fed. Reg. at [__]; Agency Proposing Release, 76 Fed. Reg. at 68,927.

[29] We note that the SEC recently incorporated the Regulation S definition into a regulation implementing a provision of the Dodd-Frank Act, which required a determination of whether a client or investor should be considered to be "in the United States." *See* Advisers Release, *supra* note 8. In adopting this regulation, the SEC noted that "Regulation S provides a well-developed body of law with which advisers to private funds and their counsel must today be familiar to comply with other provisions of the federal securities laws." *Id.*

[30] *See* SEC Release No. IA-3222, File No. S7-37-10: Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, page 115.

prospectus and prohibition of marketing to residents of the United States in the marketing agreements between investment managers and distributors) is entitled to assume that its ownership interests are not offered for sale or sold to U.S. residents for the purpose of the solely outside of the United States exception.

Regardless of what decisions the Agencies finally make in this area, they should also "grandfather" all existing non-U.S. covered funds and deem them to qualify for the solely outside of the United States exception so long as they meet the final rule's requirements on a going forward basis.

While all non-U.S. covered funds offered by qualifying non-U.S. banking entities will benefit from the recommended changes, it is worth noting that these changes will be of critical importance to non-U.S. regulated funds if such funds are not excluded from the definition of covered fund. If non-U.S. regulated funds are considered covered funds and the solely outside of the United States exception is not available, then non-U.S. banking entities seeking to invest in or sponsor covered funds outside the United States would be required to comply with the requirements of the "sponsored fund" exception, which, as discussed above, are burdensome and impractical, while U.S. banking entities offering U.S. mutual funds are definitely not subject to similar restrictions.[31]

3. The Agencies Should Clarify that Non-U.S. Funds and Investment Managers that Rely on the "Solely Outside of the United States" Exception Are Not "Banking Entities" and also Should Not Be Subject to the "Super 23A" Restrictions under Section ___.16 of the Proposed Rules.[32]

Apart from clarifying when a non-U.S. banking entity's non-U.S. covered fund activities qualify as solely outside of the United States, the Agencies also need to reconsider two aspects of the proposed rules that, if not corrected, could substantially undercut the benefits of such exception. **Specifically, BVI respectfully submits that the Agencies (i) revise the definition of banking entity to exclude covered funds and investment managers**

[31] *See* Section ___.12.

[32] Reference is made to Questions 5, 6, 7, 314, 315, and 316 in the Proposing Releases.

that rely on the solely outside of the United States exception, and (ii) also exclude such qualifying funds and entities from the so-called "Super 23A" restrictions.

The amendment to the definition of banking entity is necessary to avoid creating the anomalous situation where the covered fund that has the least connections to the United States is subject to the harshest restrictions. In this respect, the Proposing Release acknowledged that the definition of banking entity was so broad, and potentially circular, that a covered fund could be found to be a banking entity and therefore subject to a prohibition on proprietary trading.[33] To avoid this clearly unintended result, the proposed rules would create an exception for covered funds that rely on the sponsored fund exception,[34] but are silent as to the treatment of the covered funds relying on the solely outside of the United States exception. No policy reason was articulated for treating non-U.S. covered funds that have little or no contacts with the United States as banking entities, and accordingly a similar exception to the definition of banking entity should be provided.

The exclusion of covered funds and fund managers that rely on the solely outside of the United States exception from application of the Super 23A restrictions is needed to avoid an unnecessary and largely unprecedented application of United States jurisdiction to activities that are unrelated to the United States and do not raise the issues that the Volcker Rule was intended to prevent, while at the same time placing significant burdens on foreign funds and their managers. In this respect, the Super 23A restrictions would prohibit a banking entity and any of its affiliates from engaging in a broad range of "covered transactions" with a covered fund for which the banking entity or affiliate serves as an investment manager, commodity trading adviser, or sponsor.[35] These prohibitions are often referred to as the Super 23A restrictions because, while they are based on Section 23A of the Federal Reserve Act, they are not accompanied by the related exceptions and quali-

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[33] CFTC Proposing Release, 77 Fed. Reg. at [__]; Agency Proposing Release, 76 Fed. Reg. at 68,855-56.

[34] *See* Section ___.2(e)(4).

[35] *See* Section ___.16 of the proposed rules. This provision prohibits a banking entity and any affiliate that serves as an investment manager, commodity trading adviser, or sponsor to a covered fund from engaging in any transaction with the covered fund that would constitute a "covered transaction" under Section 23A of the Federal Reserve Act, as if the banking entity and affiliate were a member bank and the covered fund were an affiliate thereof.

fications of that Section and Regulation W, its implementing regulation.[36]

Absent clarification in the final rules, the Super 23A restrictions could prohibit not only loans or extensions of credit to a covered fund (the classic “covered transaction”), but also potentially purchases of assets from a covered fund and a variety of other transactions that could cause the banking entity or a subsidiary to have credit exposure to the covered fund. These restrictions would apply to transactions between a banking entity and a covered fund it sponsors, manages, organizes or offers, even where the participants in the transactions are neither incorporated nor present in the United States, and the transactions are conducted solely outside of the United States. There are no discernible policy reasons which could support such extensive application. The solely outside of the United States exception is based upon the fact that the covered fund activities in question are conducted by non-U.S. banking entities outside the United States with such limited U.S. contacts that the extraterritorial application of the Volcker Rule is inappropriate. We believe that the extraterritorial application of the Super 23A restrictions to these funds is equally inappropriate.

To illustrate the potential impact of the proposed rules, the Super 23A restrictions could inhibit the non-U.S. banking entities’ ability to provide liquidity to the non-U.S. covered fund in order to warrant redemptions of fund units by non-U.S. investors. In Europe, it is common practice that investment managers purchase units or shares of managed funds, especially to ensure that redemptions in open-ended funds investing in illiquid assets such as open-ended real estate funds can continue without disruptions. In difficult market phases, it might otherwise be difficult to equip such funds with sufficient liquidity in order to avoid suspension of redemptions. To that end, the investment managers’ investments serve the purpose to safeguard proper functioning of the covered fund and are clearly in the best interest of the fund’s investors.

In this context, it is important to note that many European funds lack legal personality which renders them ineligible to become parties to a transaction. Instead, any transactions on behalf of such contractual type funds are being

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36 *See* 12 U.S.C. § 371c, as interpreted and implemented by Subparts B through D of Regulation W (12 C.F.R. § 223.11 *et seq.*). Section 23A and Regulation W contain various qualifications and exceptions for various types of transactions that would constitute “covered transactions.” However, Super 23A simply prohibits all covered transactions, without regard to whether the covered transactions would be subject to an exception or qualification under Section 23A or Regulation W.

concluded by the responsible investment manager. Therefore, it is necessary that the application of the Super 23A restrictions be suspended also with regard to investment managers of non-U.S. covered funds relying on the solely outside of the United States exception.

We hope that our suggestions are helpful for the Agencies in finding the proper balance between endorsing the regulatory goals and avoiding undue extra-territorial impact of the Volcker Rule. Please do not hesitate to contact us if you have any questions about the foregoing comments or wish to engage in further discussions of the subject matter at hand.

Yours sincerely

Thomas Richter Dr. Magdalena Kuper