American Bankers Association
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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 – Docket ID OCC-2020-0002 (OCC); Docket No. R-1694, RIN 7100-AF70 (Federal Reserve); RIN 3064-AF17 (FDIC); File Number S7-02-20 (SEC); RIN 3038-AE93 (CFTC)

Ladies and Gentlemen:

The American Bankers Association[1] (ABA) appreciates the opportunity to provide comments to the five federal regulatory agencies (Agencies) responsible for issuing the rules (Regulation) that implement Section 619 of the Dodd-Frank Act, codified as Section 13 of the Bank Holding Company Act of 1956, as amended (Volcker Rule, or Rule). The Agencies are soliciting public comment on proposed amendments to the Regulation (Proposal) that are intended to continue the Agencies' efforts to improve, clarify, and streamline the Volcker Rule's regulatory requirements, thereby addressing the regulatory burden and improving agency administration and supervision.[2]

[1] The American Bankers Association is the voice of the nation's $18.6 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $14.5 trillion in deposits, and extend more than $10.5 trillion in loans. Learn more at www.aba.com.
[2] *See* 85 *Fed. Reg.* 12,120 (2020). *See also* 12 U.S.C. § 1851 (Volcker Rule). Each of the five federal regulatory agencies has incorporated the Regulation into its respective rules. *See* 12 C.F.R. Part 44 (Office of the Comptroller

We commend the Agencies for their ongoing efforts to amend the Regulation consistent with the congressional purpose of the Volcker Rule. We agree with Federal Reserve Chair Jerome Powell that "a simpler, clearer approach to implementing the rule makes it easier for both banks and regulators to carry out the intent of the rule."[3] As we have stated previously, the Regulation – with its vaguely defined terms, uneven treatment, and subjective tests devised to capture improper proprietary trading and covered fund investment activity – needlessly has complicated the statutory requirements, driving up the cost of compliance and negatively impacting economic activity.[4] The Agencies' studied and thoughtful recommendations for reform, therefore, are an important recognition of the need to rightsize and tailor the Volcker Rule's regulatory framework. We concur with the Agencies' actions on regulatory reform and support adoption of the Proposal, with recommendations for additional modifications as described below. In light of the COVID-19 pandemic, we note that expedited approval of the Proposal would allow banking entities to invest in community relief and development efforts and promote capital formation through the establishment of, and/or investment in, the proposed excluded funds described herein, including public welfare and venture capital funds.

I. Background.

We have mentioned in prior correspondence that the covered fund provisions remain a formidable challenge both to the Agencies and to banking entities (*i.e.*, banks and their affiliates).[5] As with a number of the originally enacted provisions on proprietary trading, a number of the covered fund requirements beg the question of why they apply to the investment activities of banking entities, particularly where proprietary trading – the crux of the Volcker Rule – is *not* present. Similarly, the draconian restrictions imposed on banking entity and affiliated covered fund relationships derives from an overly narrow interpretation of the Volcker Rule's Super 23A requirements. These restrictions unnecessarily impair the ability of a banking entity to make lawful fund investments that should be clearly beyond the scope of the Regulation.

As a result, those covered fund investments which should be permitted, and which therefore should *not* be implicated under the Volcker Rule, instead must undergo an individualized, detailed, exacting, and complex legal and regulatory analysis on whether the investment passes muster under the federal securities laws (*i.e.*, the Investment Company Act of 1940) as well as the Regulation, and if it does, must continually be monitored for compliance. Moreover, bank services to affiliated covered funds, due to Super 23A regulatory restrictions, must be outsourced to third parties, resulting in industry inefficiencies and customer costs. Not only does this disrupt customer service, but it also leads to reduced availability of investment, advisory, and wealth management products and services upon which their customers have come to rely. This

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of the Currency) (OCC); 12 C.F.R. Part 248 (Board of Governors of the Federal Reserve System) (Federal Reserve); 12 C.F.R. Part 351 (Federal Deposit Insurance Corporation) (FDIC); 17 C.F.R. Part 75 (Commodity Futures Trading Commission) (CFTC); 17 C.F.R. Part 255 (Securities and Exchange Commission) (SEC). This letter cites to OCC regulations when reference is made to provisions of or proposed amendments to the Regulation, 12 C.F.R. Part 44.

[3] Statement of Federal Reserve Chair Jerome H. Powell on Proposal (Jan. 30, 2020).

[4] *See* ABA Letter to the Agencies on the 2018 proposal to amend the Volcker Rule regulation (Oct. 17, 2018) (ABA October 2018 Letter).

[5] *See, e.g.,* ABA Letter to OCC (Sept. 21, 2017) at https://www.aba.com/Advocacy/commentletters/Documents/cl-Revising-Volcker2017.pdf.

is an unfortunate and unnecessary result, particularly in dealing with fund structures where, in the words of Federal Reserve Vice Chair Randall Quarles, "existing law has always allowed banks to engage directly in these activities."[6]

II. **The Proposal**.

We believe that the Volcker Rule's statutory language provides the Agencies with the appropriate regulatory authority to revise the Regulation so that it properly aligns with the intent and purpose of the statute. The following details our comments to the various proposed amendments to the Regulation. We also suggest additional improvements and refinements that would strengthen further regulatory functionality and compliance certainty, thereby supporting the regulatory goals of reform. As with the recent amendments on proprietary trading, the covered fund and Super 23A reforms will promote those traditional banking practices that pose no systemic threat to the financial system while preserving the supervisory tools necessary to sustain safe and sound banking.

A. **Covered Fund Exclusions**.

The covered funds provisions of the Volcker Rule were enacted so that a banking entity could not evade *indirectly* the prohibition on proprietary trading through the establishment and management of funds engaged in that activity. The Agencies, however, have acknowledged their overbroad interpretation of the Regulation's "covered fund" definition, which has captured a variety of funds that were never intended to be covered under the Volcker Rule. We believe that the Agencies' approach to add new exclusions while preserving and amending existing exclusions would be the most efficient way to address regulatory reform.[7] Consistent with this regulatory approach, we request that the Agencies confirm that (i) a banking entity need only comply with the requirements applicable to the banking entity or fund in order to rely on any of the exclusions provided in the Regulation,[8] and (ii) the exclusions contained in the Regulation are not the sole means for a fund to be excluded from the definition of "covered fund."[9]

1. **Credit Funds**.

Credit funds engage in a traditional, core banking activity – lending money on a long-term basis to companies and providing credit, liquidity, and support for capital formation needs or requirements. These funds, therefore, do not raise the concerns that the Volcker Rule was

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[6] Statement of Federal Reserve Vice Chair Randall K. Quarles on Proposal (Jan. 30, 2020).

[7] We further believe that section (d)(1)(J) of the Volcker Rule provides the requisite authority for the Agencies to align the covered fund definition in this manner. *See* 12 U.S.C. § 1851(d)(1)(J).

[8] For example, it is possible that the disclosure requirements under the proposed exclusion for family wealth management vehicles will not accurately describe the relationship between the vehicle and the banking entity. *See* 12 C.F.R. § 44.11(a)(8)(i)(A) (disclosure referencing possible losses to the banking entity in the family wealth management vehicle when the bank retains no ownership interest in the vehicle, thus creating unnecessary confusion among family members receiving the disclosure).

[9] Banking entities, in other words, will continue to make determinations on whether a particular entity or fund comes within the definition of "covered fund" and may rely on bases other than the exclusions available under the Regulation. For example, a fund may rely on an exclusion under the Investment Company Act of 1940 (Investment Company Act) that does not involve reliance under section 3(c)(1) or 3(c)(7) of the Investment Company, or a banking entity otherwise may determine that such fund is not a "covered fund" for purposes of the Volcker Rule.

intended to address. As the Federal Reserve notes, "the legislative history of the Volcker Rule indicates that Congress targeted the covered funds provisions at private equity funds and short-term focused hedge funds, not private long-term debt funds."[10] The Proposal would expressly authorize banking entities to invest in or sponsor those credit funds that satisfy the qualifying provisions and the limits in the revised Regulation, which among other things would include prohibitions on proprietary trading by the fund and the banking entity's guaranteeing the performance of the fund, as well as compliance with the provisions of Super 23A.[11]

We agree with and support the covered fund exclusion for credit funds. We note that the Proposal permits credit funds to hold equity securities "received on customary terms in connection" with investments in loans and debt instruments."[12] We agree that credit funds should be permitted to hold equity securities (as well as other non-loan and non-debt assets) in this manner. We recommend that no numerical or percentage limitations be placed on the amount of equity/non-loan/non-debt securities that may be held in connection with loans and debt instruments, but that such holdings instead be subject to arms-length market transactions and to bank safety and soundness. Additionally, we request that the Agencies (i) permit credit funds to hold other non-qualifying assets, such as preferred stock and other equity securities or assets, in an amount that does not exceed 20% of the fund's total assets, and (ii) confirm that loans held by qualified credit funds not be subject to specified credit quality standards. As a safeguard, the Agencies possess the requisite supervisory tools to examine these activities and retain the regulatory authority to request bank-specific adjustments to these holdings as circumstances warrant.

2. <u>Venture Capital Funds</u>.

Venture capital funds are a critical catalyst for economic growth, innovation, competition, and job creation at the local, regional, and national levels. Under the Regulation, venture capital funds may fall within the definition of covered fund. Properly conducted investments in venture capital funds, however, do not raise the concerns associated with the short-term high-risk activities that are the focus of the Volcker Rule. Moreover, the congressional record indicates an affirmative intent to *exclude* venture capital funds from the Volcker Rule.[13] In discussing the Dodd-Frank Act, Senator Dodd asserted that venture capital investment "will not cause the harms at which the Volcker Rule is directed" and expected federal regulators to use their exemptive authority to preserve properly conducted venture capital investment.[14] To ensure that the Volcker Rule restrictions reflect congressional intent and purpose, the Proposal would permit banking entities to sponsor and invest in those venture capital funds that qualify for the exclusion under the amended Regulation, with conditions similar to those applicable to qualifying credit funds.[15]

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[10] Federal Reserve Staff Memorandum on Proposal (Jan. 23, 2020) (Fed Staff Memo) at 7.
[11] *See* 85 *Fed. Reg.* at 12,178.
[12] 12 C.F.R. § 44.10(c)(15)(i)(C)(iii) (proposed), 85 *Fed. Reg.* at 12,178.
[13] *See* Statement by Rep. Eshoo (D-CA), 156 *Cong. Rec.* E1295 (July 13, 2010); colloquy between Sen. Dodd (D-CT) and Sen. Boxer (D-CA), 156 *Cong. Rec.* S5904-5 (July 15, 2010).
[14] 156 *Cong. Rec.* at S5905.
[15] *See* 85 *Fed. Reg.* at 12,178-79.

We agree with and support the venture capital fund exclusion from the covered fund definition. We believe, however, that the exclusion's provision that requires banking entities investing in a qualifying venture capital fund – and that do *not* sponsor or advise the fund – to be nevertheless subject to the provisions of Super 23A is inconsistent with the intent of the statute, and therefore, should be removed from the exclusion's requirements.[16] Moreover, the Agencies should refrain from prohibiting qualifying venture capital funds from investing in companies over a certain dollar amount of total annual revenue (*e.g.*, $50 million), since this would artificially cap otherwise permissible investments and unnecessarily discriminate among portfolio companies based on industry-specific business and revenue models.[17]

3. **Customer Facilitation Funds**.

A customer facilitation fund is a special-purpose vehicle that is used solely to structure a transaction exposure, investment strategy, or other service for a single client (or group of affiliated clients) of a banking entity that is created by, and at the request of, such client(s) to provide for the client's particular business needs or objectives.[18] These and other similar structures are used as part of the client-facing businesses of banking entities to provide clients with financing or exposure to particular, client-specified investments and should not raise concerns about indirect proprietary trading by banking entities. Nevertheless, although the structured vehicle provides the client with the same economic exposure to the underlying financial product, such vehicle may be deemed a covered fund under the Regulation. The Proposal would create an exclusion from the covered fund restrictions for these funds, while establishing eligibility criteria (similar to those that apply to the other proposed exclusions) that would address possible evasion concerns under the Volcker Rule.[19]

We agree with and support the exclusion for customer facilitation vehicles. We believe that such exclusion will give banking entities the increased flexibility to provide and respond to client-specific financial requirements and objectives. We further agree with the Agencies that these vehicles do not expose banking entities to the types of risks that the Volcker Rule was intended to prohibit or limit.[20] As referenced in the preamble, it is important that a banking entity be permitted to market its services in this area and discuss the potential benefits of particular types of vehicles with potential and existing clients so that they are made aware of the availability of such services and vehicles prior to the formation of the customer facilitation fund.[21]

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[16] Super 23A applies only to a banking entity that serves "as the investment manager, investment adviser, or sponsor" to a covered fund, or that "organizes and offers" a covered fund. 12 U.S.C. § 1851(f)(1). Therefore, as amended, the relevant proposed section (§ __.10(c)(16)(iv)) should apply the provisions of Super 23A only to those banking entities that act "as a sponsor, investment adviser, or commodity trading advisor to an issuer [venture capital fund] that meets the conditions in paragraph (c)(16)(1) of this section." *Cf.* § __.10(c)(16)(ii) (proposed).

[17] Moreover, the total annual revenue of a portfolio company, by itself, has no bearing on whether it is engaged in unlawful proprietary trading or covered fund activity that the Volcker Rule was intended to address.

[18] Certain banking entity clients, when seeking financing or other core banking services, prefer to use special-purpose vehicles to facilitate lending transactions, for a variety of legal, counterparty, risk management, accounting reasons.

[19] *See* 85 *Fed. Reg.* at 12,179.

[20] *See id.* at 12,141.

[21] *Id.*

4. **Family Wealth Management Vehicles**.

Family wealth management vehicles have long been used to implement familial objectives, including estate, gift, and income tax planning, corporate succession of family businesses, and the collective management of family assets, philanthropy, and charitable gifts. In order to manage effectively these activities, families create such vehicles as limited partnerships, limited liability companies, or trusts, and solicit accompanying services from banking entities, including custody of assets, investment management and advice, tax preparation, recordkeeping, and corporate trust services. Unlike hedge funds and private equity funds, family wealth management vehicles are intended to be owned by, and provide services to, members of a single family (*i.e.*, immediate and extended family members) and closely related persons who assist in administering, managing, or advising on the vehicles.

ABA and its member institutions believe, based on well-reasoned legal advice of outside counsel, that many family wealth management vehicles do not require reliance on the exclusions in sections 3(c)(1) or 3(c)(7) of the Investment Company Act, and therefore, do not raise covered fund concerns.[22] Moreover, we agree with and support the Proposal's express covered fund exclusion for family wealth management vehicles. The Proposal provides that a fund would qualify for the covered fund exclusion as a family wealth management vehicle, provided that (i) it is owned by members of a single family and no more than three "closely related persons" of the family customers,[23] and (ii) complies with the qualifying conditions of the exclusion.[24] We recommend that ownership of a family wealth management vehicle be permitted for up to 10 "closely related persons" since a number of these vehicles may require the services of more than the three persons allowed under the Proposal.[25] We also request that the Agencies do not impose on banking entities the disclosure requirements of the asset management exclusion,[26] as such disclosures may create confusion where the banking entity does not own an interest in the family wealth management vehicle, or where such vehicles do not generate or possess the relevant documentation (*e.g.*, offering documents) for such disclosures.[27]

5. **Loan Securitization Exclusion**.

Although the Volcker Rule expressly allows banking entities to sell and securitize loans, the narrowly drawn conditions of the current loan securitization exclusion unnecessarily has compelled a number of banking entities either to divest or restructure their interests in loan securitizations in order to conform to the regulatory restrictions. The Proposal would provide relief in two ways: (i) expand the assets that a qualifying loan securitization could hold in order to permit such vehicles to hold non-loan assets, in an amount of up to 5% of the aggregate value of the securitization's total assets; and (ii) clarify that servicing assets held by such vehicle may

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[22] *See* 12 C.F.R. § 44.10(b)(1)(i) (defining a "covered fund" as an issuer that would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act).
[23] *See* § ___.10(c)(15)(iii)(A).
[24] *See* 85 *Fed. Reg.* at 12,179.
[25] The Proposal could be clarified to require majority ownership of the vehicle by family members in order to ensure that it is not used to evade the intent and language of the Volcker Rule.
[26] *See* 12 C.F.R. § 44.11(a)(8).
[27] Such requirements also place banking entities at a competitive disadvantage to investment managers who are not subject to the Volcker Rule.

include assets other than securities, such as mortgage insurance policies, that qualify for the eligibility criteria in the amended exclusion.[28] The proposed inclusion of other assets would provide flexibility for banking entities to respond to market and customer demands in the collateralized loan obligation (CLO) market. We recommend that the non-loan asset bucket be calibrated at 10% of total assets to allow additional flexibility to manage the loan securitization portfolio in times of unexpected or extended stress or volatility in the financial markets. In order to maintain streamlined administration, we further suggest that the percentage limitation on non-loan assets be calculated by reference to the par value of such assets at the time of their purchase.

6. Small Business Investment Companies (SBICs).

The Agencies propose to amend the Regulation's SBIC exclusion from the covered fund definition by extending the exemption for any SBIC that has voluntarily surrendered its license to operate as an SBIC, provided that the SBIC does not make any new investments (other than investments in cash equivalents) after the voluntary surrender. Since this amendment would allow both the SBIC and banking entity investors to continue to rely on the exclusion during an SBIC's routine wind-down period, we agree with and support the Agencies' proposed revision.

7. Additional Funds for Exclusion.

In addition to the qualifying excluded funds described under the Proposal, we believe for the reasons below that the following funds likewise should merit an exclusion from the covered fund definition.

a. Long-Term Investment Vehicles.

The overbroad definition of covered fund captures entities engaged in otherwise permissible and properly conducted activities, such as long-term investment vehicles that provide capital for infrastructure assets, real estate developments, and growing companies that banks otherwise are permitted to engage in directly. Such entities also include any start-up, technology, incubator, and other operating company that, due to the asset composition of its balance sheet, may fail the Investment Company Act's so-called "40% test," and thereby inadvertently become a covered fund.[29] These qualifying vehicles and operating companies, however, neither engage in short-term proprietary trading nor are involved in the high-risk activities that the Volcker Rule's backstop provisions are intended to address.[30] Furthermore, any banking entity that sponsors or invests in the long-term investment fund does not guarantee, assume, or otherwise insure the obligations or performance of such fund. We believe that the Agencies should exclude these long-term investment vehicles and companies since they are clearly outside the purview of the Volcker Rule. The Agencies, moreover, possess the necessary supervisory tools to ensure that

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[28] *See* 85 *Fed. Reg.* at 12,177.

[29] The Investment Company Act provides that any company engaged in the business of investing, reinvesting, owning, holding, or trading in securities and owns investment securities exceeding 40% of the company's total assets is required to register as an investment company, absent an exemption, thus forcing such company to rely on the section 3(c)(1) or 3(c)(7) exclusions in order to avoid investment company status. *See* 15 U.S.C. § 80a-3(a)(1)(C).

[30] *See* 12 U.S.C. § 1851(d)(2).

any such fund would not be established and maintained for the purposes of evading the requirements of the Volcker Rule.

b. Public Welfare Investment Entities and Foundations.

In the preamble, the Agencies note our comment in a prior letter that the Regulation's exclusion for funds designed primarily to promote the public welfare does not account for community development investments made through investment vehicles.[31] In that letter, we recommended that the Agencies expressly exclude all investments that qualify for Community Reinvestment Act (CRA) credit, including direct and indirect investments in a community development fund, SBIC, or similar fund. As the Agencies point out, it is uncertain how the exclusion applies to specific community development investments that are made through fund structures (*e.g.*, a fund designed to invest in low- and moderate-income housing) but which otherwise clearly advance the public welfare. We believe it would be useful and appropriate for the Agencies to make clear that any CRA-qualified investment fits squarely within the exclusion for public welfare investments. In the same vein, the Agencies should exclude qualified opportunity funds (QOFs) in the same manner as SBICs and public welfare companies, since this would further provide certainty with respect to such public welfare investments. We further request that the Agencies exclude from the definition of "banking entity" any public welfare entity and foundation and any entity that is established for purposes of facilitating CRA investments.[32]

c. Funds in the Seeding Process.

The Regulation currently provides that a banking entity that establishes a covered fund, and provides it with sufficient initial equity ("seeding") to permit the fund to attract unaffiliated investors, no later than one year after the fund's establishment (unless the Federal Reserve expressly provides advance approval for a longer period) must conform its ownership interest to the 3% investment limit required under the Regulation.[33] The Proposal does not expressly address this limited seeding period. We believe, however, that this one-year seeding period is unnecessarily restrictive and has greatly limited banking entities' ability to establish funds for their customers. The constrained time limit especially makes it challenging to attract third party investors, many of whom expect an investment performance track record before committing funds for an initial investment in the newly created fund. This fundraising obstacle thus places an artificial cap on the creation of investment vehicle products. We recommend, therefore, that the Agencies use their exemptive authority under the Volcker Rule[34] to create an exclusion from the covered fund prohibition for those funds during the seeding period of the fund.[35] In order to address evasion concerns, the Agencies can examine the fund during the banking entity's routine

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[31] *See* 85 *Fed. Reg.* at 12,130. *See also* ABA October 2018 Letter at 15.

[32] The primary intent of these funds is to promote the public welfare. Any additional fund capital not immediately invested in CRA development is managed in cash or in low-risk securities for purposes of maintenance. Therefore, the purpose of such funds is not, and could not be, to trade impermissibly as a vehicle for proprietary investments under the Volcker Rule. Moreover, investments in such funds do not expose the banking entity to unnecessary risk or pose a threat to the safety and stability of the US financial system under the Volcker Rule. *See* 12 U.S.C. § 1851(d)(1)(J). Such funds, therefore, should not be classified as a "banking entity."

[33] *See* 12 C.F.R. § 44.12(a)(2)(1)(B).

[34] *See* 12 U.S.C. § 1851(d)(1)(J).

[35] In addition to covered funds, excluded funds such as registered investment companies (RICs) and foreign public funds also should receive an exemption. *See* Federal Reserve, *Volcker Rule FAQ 16* (July 16, 2015).

examination to confirm that the banking entity is complying with the requirement to "actively seek unaffiliated investors" in order to reduce the bank's ownership interest in the fund."[36]

B. Covered Fund Compliance.

1. Definition of Ownership Interest.

The Volcker Rule places investment restrictions and a capital deduction with respect to a banking entity's "ownership interest" in a covered fund. The Volcker Rule, however, does not contemplate any expansion of the term "ownership interest" beyond the ordinary understanding of the term. The Regulation's definition of "ownership interest," which includes any equity, partnership, or other "similar interest," nonetheless captures certain forms of holdings that are not intended to possess, exhibit, or exercise ownership interest or rights.[37] The Proposal would amend the term to clarify that a loan or debt interest with certain creditor rights would not be deemed an "ownership interest," and further would provide a safe harbor for senior loans and senior debt.[38] While we welcome this reduced regulatory uncertainty caused by the term's overbroad reach, the term could be further sharpened to apply *only* to equity and equity-like interests that are commonly understood to indicate a *bona fide* interest in a covered fund.[39] We believe that this simplified, focused approach would properly align "ownership interest" with industry experience and the policy objectives of the Volcker Rule.

2. Definition of Banking Entity.

The Agencies have not proposed any revisions to the definition of "banking entity." We believe, however, that the current definition is too broad and sweeps in entities whose classification as a banking entity does not further policy objectives. For example, making clear that employee securities companies (ESCs) are not banking entities, despite the banking entity's role as a general partner as required under SEC rules, would help reduce an area of unnecessary administrative burden under the Volcker Rule and further would be consistent with the policy goal, as described in the preamble, to allow banking entity employees and directors to make direct investments alongside a covered fund.[40] We also reiterate our recommendation that the Agencies should exclude from "banking entity" any company that is not consolidated with a bank holding company, provided that the company's activities are not managed or operated by a

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[36] *See* 12 C.F.R. § 44.12(a)(2)(i)(A). We are aware of the Federal Reserve's authority to extend the seeding period for up to two additional years under the Regulation. *See* 12 C.F.R. § 44.12(e). However, the length of the Federal Reserve's approval process, combined with the uncertainty of agency approval (and the sufficiency of the time period extension in the event of approval) negatively factor into the banking entity's decision whether to proceed at all with the creation of the fund.

[37] *See* 12 C.F.R. § 44.10(d)(6).

[38] *See* 85 *Fed. Reg.* at 12,179-80.

[39] So for example, under such a refined definition, the following events would *not* constitute an "ownership interest": (i) senior loans and senior debt securities that include acceleration of amortization provisions with respect to repayment of principal; (ii) tranches of securitizations that may at times receive principal payments from diverted subordinate cash flows, due to the failure of deal triggers;" (iii) debt instruments for which missed payments of interest or principal would constitute an "event of default" under the governing documents;" and (iv) removal of the asset manager for cause, and/or a vote on a nominated replacement manager, *prior to* an event of default or acceleration.

[40] *See* Section II.E.2., *infra.*

banking entity. For the reasons discussed above,[41] public welfare investment entities and foundations and entities established for the purpose of facilitating CRA investments likewise should be excluded from the definition of "banking entity." These exclusions would properly recognize that such entities were never intended to be captured by the Volcker Rule.

C. Super 23A.

The Volcker Rule's "Super 23A" provision prohibits a banking entity from entering into any transaction with certain related hedge funds and private equity funds, if the transaction would be a "covered transaction" as defined under Section 23A of the Federal Reserve Act.[42] The Proposal would tailor and align the Regulation with the language and intent of the Volcker Rule by (i) permitting a banking entity to enter into transactions with a related fund that would be permissible without limit under Section 23A, which would include intraday extensions of credit and extensions of credit that are fully secured by US Treasuries, and (ii) allow a banking entity to engage in certain transactions with such fund in connection with payment, clearing, and settlement services and activities.[43] As the Federal Reserve staff noted, such reforms provide banking entities "with greater flexibility to provide standard payment, clearing, and settlement services to a related fund, rather than requiring such services to be provided by an unaffiliated service provider," which has served only to drive up costs and increase the operational risks arising from the division and outsourcing of bundled turnkey services (*e.g.*, custody, fund administration and accounting).[44]

We agree with and support the Agencies' proposal to facilitate these traditional banking activities performed in the ordinary course of business.[45] We recommend that the Agencies confirm that a banking entity may engage in a covered transaction that is exempt under section 223.42 of the Federal Reserve's Regulation W[46] (including those applicable to transactions with securities affiliates), consistent with the Agencies' intent to incorporate Section 23A and Regulation W's exemptions into Super 23A. We recommend further that the Agencies use their exemptive authority[47] to exclude Super 23A's applicability to banking entities that serve in an advisory capacity to a covered fund, where the banking entity does not hold an ownership interest in, or sponsor or organize, such fund, since such exclusion does not present the conflicts that Super 23A is intended to prevent and is consistent with the Agencies' objective to permit

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[41] *See* Section II.A.7.b., *supra*.
[42] *See* 12 U.S.C. § 1851(f) (Super 23A); 12 U.S.C. § 371c (Section 23A).
[43] *See* 85 *Fed. Reg.* at 12,181-82.
[44] Fed Staff Memo at 5.
[45] As stated in our previous letter, the condition that any such transaction be conducted consistent with safe and sound banking practices serves to retain the Agencies' authority to examine these activities for compliance with the Volcker Rule, and to disallow any transaction which they believe amounts to an evasion of the Volcker Rule's requirements. *See* 12 U.S.C. § 1851(e)(2).
[46] *See* 12 C.F.R. § 223.42 (2020).
[47] *See* 12 U.S.C. § 1851(d)(1)(J). Although the language of this exemptive authority provision infers that it applies only to proprietary trading and covered fund investment activity, section (d)(1)(J) authority likewise should be available to provide exemptions from one or more of the prohibitions under Super 23A, since Super 23A's prohibitions arise directly out of, and are intended to impact, a banking entity's covered fund investment activity.

banking entities to provide their clients "a more comprehensive suite of services to related covered funds, reducing the need to rely on third parties to provide such services."[48]

D. Foreign Funds.

1. Foreign Public Funds.

Although qualifying foreign public funds already are excluded under the Regulation, the conditions which must be satisfied to rely on the exclusion amount to an awkward and impractical fit for a number of these funds.[49] Under the Proposal, a foreign public fund may qualify for the covered fund exclusion if it is organized or established outside the US and is authorized to offer and sell ownership interests (and such interests actually are offered and sold) through one or more public offerings.[50] The Proposal thus would remove two primary obstacles that prevent foreign public funds from relying on the current exclusion: (i) the requirement that the foreign public fund offer and sell ownership interests to retail investors in the fund's home jurisdiction (rather than where the interests are *actually* sold, which often are outside the home jurisdiction); and (ii) the requirement that fund interests be "predominantly" sold through one or more public offerings that occur outside the US (which involves significant compliance and monitoring challenges).[51] The Proposal thus works toward aligning the treatment of foreign public funds with the treatment of US mutual funds. We therefore agree with and support the Agencies' proposed revisions, which would accommodate the special attributes of a foreign public fund consistent with the purposes of the statute. We recommend that the Agencies confirm that a foreign public fund automatically qualifies for the exclusion if the fund's ownership interests are listed on an internationally recognized exchange that allows for trading for retail investors since this would tailor compliance for these exchange-traded funds and foster comparable treatment with US mutual funds.

2. Foreign Excluded Funds.

Foreign funds that are not offered or sold to US investors ("foreign excluded funds") ordinarily would have no nexus to the Volcker Rule. Such funds, however, may nevertheless become captured by the Volcker Rule if controlled by a foreign banking organization (FBO), since the fund would then become a "banking entity" under the Regulation, and therefore subject to the restrictions on proprietary trading and covered fund investments.[52] Since 2017, the Agencies have provided foreign excluded funds several temporary exemptions that avoid this anomalous result, which the Proposal would codify in the Regulation.[53] We agree with the Agencies that providing this permanent relief would limit the extraterritorial effects that the Volcker Rule otherwise would impose. It is further consistent with FBOs' experience in offering and selling interests in foreign excluded funds, without raising the concerns that the Volcker Rule was

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[48] 85 *Fed. Reg.* at 12,145. Moreover, the banking entity still would be subject to the restrictions governing covered transactions under Section 23A and Regulation W. *See* 12 U.S.C. § 371c; 12 C.F.R. § 223.
[49] *See* 12 C.F.R. § 44.10(c)(1).
[50] *See* 85 *Fed. Reg.* at 12,177.
[51] *Id.*
[52] Although *covered* funds are excluded from the definition of "banking entity," there is no corresponding exemption for foreign excluded funds.
[53] *See* 85 *Fed. Reg.* at 12,181.

intended to address. We therefore agree with and support the proposed changes that would exempt qualifying foreign public funds.

E. **<u>Parallel Investments with Covered Fund</u>**.

Although not expressly prohibited in the Regulation, the Agencies stated in the preamble to the original Regulation that certain direct investments of a banking entity that parallel those of a covered fund that the entity organizes and offers (i) would be treated as if they were investments in the covered fund itself, and therefore (ii) would be subject to the 3% per fund investment limit under the Regulation's asset management exemption.[54] The Proposal would make clear, however, that investments made by a banking entity alongside covered funds would *not* be counted against the 3% per fund and aggregate limits.[55] The parallel investments must be made in compliance with applicable laws and regulations and must comply with the amended Regulation's prudential conditions afforded under the investment authority.

We agree with and support the Agencies' clarification of a banking entity's authority to make otherwise permissible investments directly on their balance sheets. We also agree with and support the Agencies' confirmation that an employee's or director's parallel investments made alongside a covered fund would not be subject to the same limits that would apply if they were made in the covered fund, "regardless of whether the banking entity arranged the transaction on behalf of the director or employee or provided financing for the investment."[56] We request that the Agencies use their exemptive authority[57] to permit banking entities employees and directors to invest directly in covered funds, regardless of whether they provide services to the covered funds on behalf of their banking entity employer.[58] This would afford banking entity employees and directors personal investment opportunities that are not part of a banking entity's trading activities intended to be covered under the Volcker Rule.

F. **<u>Implementation: Voluntary Compliance.</u>**

As they did with the amendments to the Regulation's proprietary trading provisions,[59] the Agencies should confirm that banking entities may comply voluntarily, in whole or in part, with the Proposal's amendments that are adopted by a final rule upon the rule's effective date, rather than upon the (later) compliance date. This would allow banking entities the flexibility and opportunity to expeditiously restructure and adjust their investment operations and activities to better serve their retail and institutional customers and to promote capital formation and community development through the establishment of new funds.

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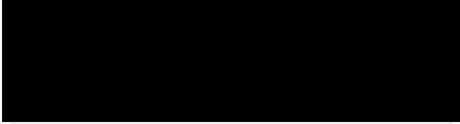
[54] *See* 79 *Fed. Reg.* at 5734 ("if a banking entity makes investments side by side in substantially the same positions as the covered fund, then the value of such investments shall be included for purposes of determining the value of the banking entity's investment in the covered fund"). This raised the question whether a banking entity had a legal obligation to track and monitor investments made directly by the banking entity in the same investments held by the affiliated covered fund. *See* Fed Staff Memo at 13.
[55] *See* 85 *Fed. Reg.* at 12,180-81.
[56] *See id.* at 12,150.
[57] *See* 12 U.S.C. § 1851(d)(1)(J), *supra.*
[58] *See* 12 U.S.C. § 1851(d)(1)(G)(vii).
[59] *See* 84 *Fed. Reg.* 61,974 (2019).

Thank you for your consideration of our views and recommendations. If you have any questions or require any additional information, please do not hesitate to contact the undersigned at 202-663-5479 (tkeehan@aba.com).

Sincerely,



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