



SUBMITTED ELECTRONICALLY

February 13, 2012

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st Street, N.W.
Washington, DC 20581

Re: Notice of Proposed Rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

Dear Sir or Madam:

These comments are submitted by the Private Equity Growth Capital Council (the "PEGCC"). The PEGCC is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 36 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.¹

¹ The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; ArcLight Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; CCMP Capital Advisors, LLC; Crestview Partners; Francisco Partners; General Atlantic; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; Irving Place Capital; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn

We are submitting this letter to the above-named agencies (the “Agencies”) with respect to the notice of proposed rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (the discussion included in the notice is hereinafter referred to as the “Preamble” and the proposed rules in the notice as the “Proposed Rules”) implementing the new Section 13 (the “Volcker Rule”) of the Bank Holding Company Act of 1956 (the “BHC Act”) adopted by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).² The PEGCC previously submitted comments to the Financial Stability Oversight Council (the “FSOC”) regarding the study required by Section 13(b) of the BHC Act (the “FSOC Study”)³ and also to the Agencies in advance of the Proposed Rules. Copies of the PEGCC’s comment letters are attached.

Although the PEGCC’s members are not themselves directly subject to the Volcker Rule, the Volcker Rule will impact the ability of private equity firms to raise capital from certain groups of investors. The PEGCC believes that the Agencies have appropriately interpreted certain aspects of the Volcker Rule in the Preamble and the Proposed Rules, particularly with respect to (i) the exclusion of funds organized and offered under BHC Act Section 13(d)(1)(G) from the definition of “banking entity,” (ii) the interpretation that qualified pension plans for banking entity employees are not subject to the covered fund investment prohibitions of the Volcker Rule and (iii) the permission of U.S. private equity firms to act as sponsors (manage, organize or advise) to covered funds that satisfy the exemption in Section 13(c) of the Proposed Rules.

However, the PEGCC would like to comment on the ability of the following entities to invest in private equity funds that are sponsored by private equity firms that are not banking entities (“Third Party Private Equity Funds”): (i) insurance companies through their general accounts and separate accounts; (ii) banking entity employees and employee vehicles (including pension plans); (iii) other covered funds in which banking entities are permitted to sponsor or invest; and (iv) non-U.S. banking entities.

Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

² 76 Fed. Reg. 8,265 (Nov. 7, 2011).

³ FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (Jan. 2011).

I. Insurance Company General Accounts and Separate Accounts Should Be Permitted to Invest in Third Party Private Equity Funds.

As we have argued in our prior comment letters, the Volcker Rule was not intended to restrict traditional insurance activities.⁴ The Proposed Rules properly include exemptions for insurance company general accounts (Section 6(c)) and separate accounts (Section 6(b)(iii)) with respect to the proprietary trading prohibition in Section 3 of the Proposed Rules; however, the Proposed Rules do not explicitly include equivalent exemptions from the covered fund investment prohibition in Section 10 of the Proposed Rules.

The PEGCC respectfully requests that the Agencies clarify that the exemptions in Section 6(c) and 6(b)(iii) also exempt insurance company general accounts and separate accounts, respectively, from the covered fund investment prohibition in Section 10 of the Proposed Rules based on (i) the clear congressional intent and statutory language that investment activities of insurance company general and separate accounts should not be impacted by the Volcker Rule and (ii) the Agencies' authority under BHC Act Section 13(d)(1)(J), which allows the Agencies to exempt activities that promote and protect the safety and soundness of banking entities (including insurers that fall within the term "banking entity") and the financial stability of the United States.

A. Congressional Intent and Statutory Language

Congress was clear: "The Volcker Rule was never meant to affect the ordinary business of insurance."⁵ To this end, Congress specifically required that the FSOC Study include recommendations on how to "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws."⁶ The FSOC Study included recommendations to the Agencies to provide exemptions for insurance company general accounts, because they are subject to extensive regulation and oversight by insurance regulators, and insurance company separate accounts,

⁴ See PEGCC Comment Letter in Advance of Notice of Proposed Rulemaking Implementing the Private Funds Portion of the Volcker Rule (May 10, 2011) ("PEGCC Comment Letter in Advance of Proposed Rules") at Section II; and PEGCC Comment Letter Re: Financial Stability Oversight Council Request for Public Input for the Study Regarding Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (Nov. 5, 2010) ("PEGCC Comment Letter in Advance of FSOC Study") at 5-6. See also FSOC Study, *supra* note 3, at 71.

⁵ 156 Cong. Rec. S5896 (statement of Sen. Merkley).

⁶ BHC Act Section 13(b)(1)(F).

because they are transactions on behalf of customers.⁷ There is no discussion in the legislative history or in the FSOC Study that would suggest that insurance company general or separate accounts should be permitted to engage in proprietary trading but not invest in covered funds. Accordingly, the PEGCC urges the Agencies to follow the congressional intent and the recommendations of the FSOC Study to accommodate the business of insurance companies by exempting insurance company general accounts and separate accounts from the covered fund investment restrictions in Section 10 of the Proposed Rules.

In addition, the PEGCC believes that the statutory language of BHC Act Section 13(d)(1)(D) (which allows transactions on behalf of customers) and Section 13(d)(1)(F) (which allows transactions by insurers) is clear that the acquisition by insurance company general and separate accounts of limited partner interests, limited liability company interests or other interests in Third Party Private Equity Funds are intended to be excluded from the Volcker Rule. Section 13(d)(1)(D) permits “[t]he purchase, sale, acquisition, or disposition of securities and other instruments *described in* subsection (h)(4) on behalf of customers”⁸ (emphasis added), and Section 13(d)(1)(F) permits “[t]he purchase, sale, acquisition, or disposition of securities and other instruments *described in* subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company”⁹ (emphasis added).

The securities and other instruments that are “described in” BHC Act Section 13(h)(4) include, among other things, “any security, any derivative, any contract of sale of a commodity for future delivery, any option on such security, derivative, or contract, or any other security or financial instrument.” Interests in private equity and hedge funds are, and have long been recognized as, “securities,” whether those funds are organized as corporations, limited liability companies or, as is most often the case,

⁷ FSOC Study, *supra* note 3, at 73-74.

⁸ With respect to insurance company separate accounts, as the Preamble notes and as we argued in our prior comment letters, activities in insurance company separate accounts are “transactions on behalf of customers because such insurance-related transactions are generally customer-driven and do not expose the banking entity to gains or losses on the value of separate account assets, even though the banking entity may be treated as the owner of those assets for certain purposes.” Preamble, *supra* note 2, at 68,879; PEGCC Comment Letter in Advance of Proposed Rules, *supra* note 4, at Section II; PEGCC Comment Letter in Advance of FSOC Study, *supra* note 4, at 6.

⁹ The PEGCC also notes that these two provisions provide exemptions from both the proprietary trading prohibition and the covered fund investment prohibition. See BHC Act Section 13(d)(1) (saying that these activities are permitted “[n]otwithstanding the restrictions under subsection (a),” *i.e.*, both the proprietary trading and covered fund investment prohibitions).

limited partnerships.¹⁰ Therefore, a straightforward reading of BHC Act Sections 13(d)(1)(D) and 13(d)(1)(F) would permit the acquisition of securities (including the acquisition of interests in Third Party Private Equity Funds) by both insurance company general accounts and separate accounts.¹¹ The fact that Section 13(h)(4) defines “proprietary trading” activity does not change the nature of the securities that are described in that definition. Accordingly, the PEGCC urges the Agencies to follow the statutory text of the Volcker Rule and exempt insurance company general accounts and separate accounts from the covered fund investment restrictions in Section 10 of the Proposed Rules.

B. *Promotion of the Safety and Soundness of Insurance Companies*

If the Agencies conclude that the Agencies must interpret the statutory language differently than discussed above, then the PEGCC respectfully requests that the Agencies use their authority under BHC Act Section 13(d)(1)(J) to provide an exemption from the Volcker Rule’s restrictions on investments by insurance company general and separate accounts in Third Party Private Equity Funds in order to prevent an absurd result and to promote the safety and soundness of insurance companies.¹²

The covered fund prohibition was in large part included as a means to prohibit the avoidance of the proprietary trading prohibition of the Volcker Rule.¹³ Therefore,

¹⁰ See, e.g., Loss, Seligman and Paredes, Securities Regulation § 2(a)(1) (discussing definition of “security” under U.S. securities laws); Securities Act of 1933, Section 2(a)(1) (defining “security” to include, among other things, any stock or investment contract); SEC v. W.J. Howe Company, 328 U.S. 293, 298-299 (1946) (stating that an “investment contract” for purposes of the U.S. federal securities laws includes “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party”); Rule 3a11-1 under the Securities Exchange Act of 1934 (defining “equity security” to include any “limited partnership interest”).

¹¹ The PEGCC notes that, with respect to insurance company general accounts, the Preamble states that the exemption in Section 6(c) is a straightforward implementation of BHC Act Section 13(d)(1)(F). Preamble, *supra* note 2, at 68,880.

¹² The PEGCC notes that the Agencies took a similar approach with respect to the exemption in Section 13(d) of the Proposed Rules, Preamble, *supra* note 2, at 68,912, because the Agencies were concerned that the exemption included in BHC Act Section 13(h)(2) for the sale and securitization of loans did not adequately cover all activities relating to securitization. Therefore, the Agencies relied in part on their authority under BHC Act Section 13(d)(1)(J) to ensure that all necessary activities are exempted in Section 13(d) of the Proposed Rules. The PEGCC believes that, if necessary, a similar justification could be used to ensure that all insurance company general and separate account activities are exempted from the prohibitions of the Volcker Rule.

¹³ See 156 Cong. Rec. S5894 (statement of Sen. Merkley) (“Clearly, if a financial firm were able to structure its proprietary positions simply as an investment in a hedge fund or private equity fund, the prohibition on proprietary trading would be easily avoided, and the risks to the firm and its subsidiaries and affiliates would continue.”). PEGCC also notes that the other risk mentioned by

it would be an absurd result if insurance company general and separate accounts were permitted to engage in proprietary trading but prohibited from making covered fund investments.

In addition, the imposition of covered fund investment restrictions on insurance company general accounts and separate accounts could negatively impact their safety and soundness since Third Party Private Equity Funds provide important benefits, *i.e.*, diversification (due to their low historical correlation with other typical insurance company investments) and asset-liability duration matching (from matching a long-term investment with a long-term liability).

Accordingly, the PEGCC urges the Agencies to use, if necessary, their authority in BHC Act Section 13(d)(1)(J) to permit investments by insurance company general accounts and separate accounts in Third Party Private Equity Funds because it promotes the safety and soundness of insurance companies and promotes the financial stability of the United States.

II. Bank Employees and Employee Vehicles Should Be Permitted to Invest in Third Party Private Equity Funds.

A. Direct Engagement Requirement

The PEGCC believes that employees of banking entities should not face any restrictions with respect to their personal investments in Third Party Private Equity Funds. There is nothing in the statutory text of the Volcker Rule or in the Proposed Rules that would prohibit investments by banking entity employees in Third Party Private Equity Funds. However, certain language in the Preamble could be read to imply that an employee of a banking entity is permitted to invest in a covered fund only if the employee is directly engaged in providing advisory or other services to that fund (the “Direct Engagement Requirement”).¹⁴ The PEGCC notes that there is nothing in the statutory text of the Volcker Rule or in the Proposed Rules, themselves, that would impose such a requirement.

The Direct Engagement Requirement might be appropriate for banking entity employees investing in a covered fund sponsored by their banking entity employer. The PEGCC does not believe, however, that the Direct Engagement Requirement should apply to investments by banking entity employees, in their personal capacities, in Third Party Private Equity Funds. The PEGCC believes that, in such cases, the Direct Engagement Requirement would unreasonably restrict the investment options

Sen. Merkley, related to the bail out of bank-sponsored funds, does not exist with respect to Third Party Private Equity Funds.

¹⁴ Preamble, *supra* note 2, at 68,896.

available to banking entity employees and would not promote the safety and soundness of the banking entity or the financial stability of the United States. Accordingly, the PEGCC respectfully requests that the Agencies clarify that the Direct Engagement Requirement does not apply to investments by banking entity employees, in their personal capacities, in Third Party Private Equity Funds.

B. *Employee Pension Plans and Investment Vehicles*

The PEGCC supports the interpretation in the Preamble that would permit investments in covered funds by (i) qualified pension plans for banking entity employees and (ii) any other entity where the banking entity is only acting in a fiduciary capacity (including, for example, where the banking entity is acting as a general partner or trustee of an employee investment vehicle). The PEGCC agrees that a prohibition on covered fund investments by such entities is not required by the statutory text of the Volcker Rule, and that such a prohibition would not promote the safety and soundness of the banking entities or the financial stability of the United States.

III. All Covered Funds that Banking Entities May Sponsor or in Which They May Invest Should Be Excluded from the Definition of Banking Entity.

A. *Exclusion of Covered Funds Organized and Offered under Section 13(d)(1)(G)*

The PEGCC supports the exclusion of covered funds organized and offered under BHC Act Section 13(d)(1)(G) from the definition of “banking entity.” As noted in the Preamble, there would be several internal inconsistencies without such an exclusion.¹⁵ In addition, as noted in our prior comment letters, the PEGCC believes that without such an exclusion, customers of banking entities would be deprived of investment opportunities, including investments in Third Party Private Equity Funds, that banks have traditionally offered as part of their asset management services.¹⁶

B. *Exclusion of Other Covered Funds*

The PEGCC believes that all covered funds in which a banking entity is permitted to sponsor or invest should be excluded from the definition of “banking entity” in the same fashion as covered funds organized and offered under BHC Act Section 13(d)(1)(G). In particular, the PEGCC believes that a fund that satisfies Section 13(c) of the Proposed Rules (a “Section 13(c) fund”) that is sponsored by

¹⁵ Preamble, *supra* note 2, at 68,855-68,856.

¹⁶ PEGCC Comment Letter in Advance of Proposed Rules, *supra* note 4, at Section III; PEGCC Comment Letter in Advance of FSOC Study, *supra* note 4, at 4-5.

a non-U.S. banking entity should be permitted to act as a feeder fund or a fund of funds that invests in Third Party Private Equity Funds, and should not be treated as a “banking entity.” The PEGCC believes that prohibiting a feeder fund or a fund of funds that is a Section 13(c) fund from investing in U.S. Third Party Private Equity Funds (that do not themselves satisfy the exemption in Section 13(c)) would hurt the competitive standing of U.S. Third Party Private Equity Funds compared to non-U.S. funds without reducing risk in the U.S. financial system.¹⁷ Accordingly, the PEGCC urges the Agencies to exclude all covered funds in which a banking entity is permitted to sponsor or invest from the definition of “banking entity” in the same fashion as covered funds organized and offered under BHC Act Section 13(d)(1)(G).

IV. Non-U.S. Banking Entities Should Be Permitted to Invest in Third Party Private Equity Funds Managed by U.S. Private Equity Firms and Investing in U.S.-Based Assets.

The Agencies have noted that BHC Act Section 13(d)(1)(I) (as implemented in Section 13(c) of the Proposed Rules) “limits the extraterritorial application of the statutory restrictions on covered fund activities and investments to foreign firms that, in the course of operating outside of the United States, engage in activities permitted under relevant foreign law outside of the United States, while preserving national treatment and competitive equality among U.S. and foreign firms within the United States.”¹⁸

The PEGCC believes that the restrictions in the Proposed Rules on the non-U.S. operations of non-U.S. banking entities are inconsistent with this stated intention. Such extraterritorial restrictions should be avoided (and the regulation of such activities left to the non-U.S. banking entities’ home country regulators) to the fullest extent possible, consistent with the need to protect the safety and soundness of U.S. banking entities. The PEGCC understands that this view is shared by a number of non-U.S. regulators and commenters.¹⁹ In addition, the PEGCC believes, as noted in

¹⁷ The competitive standing of U.S. Third Party Private Equity Funds (particularly, those whose investors consist primarily of U.S. persons) would be impacted because U.S. Third Party Private Equity Funds are likely to find it more difficult to attract capital from Section 13(c) funds sponsored by non-U.S. banking entities than non-U.S. Third Party Private Equity Funds, which may not be as reliant on capital from U.S. persons. The PEGCC notes that certain aspects of this competitive disadvantage could be cured to the extent the Agencies adopt the interpretations suggested in Section IV of this comment letter.

¹⁸ Preamble, *supra* note 2, at 68,852.

¹⁹ For example, in his February 8, 2012 letter to Federal Reserve Chairman Ben Bernanke concerning the Volcker Rule (and the Proposed Rules), Michel Barnier, the European Commissioner for Internal Market and Services, writes: “[T]he proposed regulation raises ... a number of concerns and would appear to have implications that are disproportionate in light of the objective that the rule is trying to achieve. First of all, the draft rules as presented have an

our May 10, 2011 comment letter, that it is important for the competitive equality of the global private equity market that U.S. private equity firms be able to offer their private equity funds to non-U.S. banking entities.²⁰ For these reasons, the PEGCC requests that the Agencies ensure that Section 13(c) of the Proposed Rules does not place any restrictions on the ability of U.S. private equity firms to offer Third Party Private Equity Funds to non-U.S. persons, including non-U.S. banking entities.

The PEGCC understands that Section 13(c) of the Proposed Rules would allow a qualifying foreign banking organization to invest in a covered fund so long as three conditions are met: (i) the banking entity engaged in the investment activity is not organized under the laws of the United States or a U.S. state; (ii) no subsidiary, affiliate or employee of the banking entity that is involved in the offer or sale of an ownership interest in the covered fund is incorporated or physically located in the United States; and (iii) no ownership interest in the covered fund is offered for sale or sold to a resident of the United States.

The PEGCC generally supports this interpretation of Section 13(c) of the Proposed Rules. In particular, the PEGCC supports the language of Section 13(c), which we read not to place any restrictions or limits on the ability of Section 13(c) funds to invest in U.S.-based assets or to be managed from the United States. However, the PEGCC respectfully requests that the Agencies clarify and, if required, modify the Proposed Rules to preserve the ability of U.S. private equity firms to offer Third Party Private Equity Funds to non-U.S. persons, including non-U.S. banking entities, in the manner proposed below.

A. *Investments by Private Equity Firms and Receipt of Carried Interest*

The PEGCC requests clarification that the limit on the offer and sale to U.S. residents in Section 13(c) does not restrict the ability of U.S. private equity firms (and their affiliates and employees), so long as they are not banking entities, to make investments in (and receive carried interest from) Section 13(c) funds that are

extensive, global scope. This would seem to lead to a number of unintended, non justifiable consequences for non-US banks, markets and institutions. ... [T]he current exemption for non-US banks as well as for activities outside of the US would appear very restrictive. As a consequence, it would appear that the rule would be applied well beyond the US activities of non-US banks, without any justification being provided.”

See also Letter from Masamichi Kono, Vice Commissioner for Internal Affairs of the Japanese Financial Services Agency, and Kenzo Yamamoto, Executive Director of the Bank of Japan, Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Dec. 28, 2011) (commenting on the need to limit extraterritorial application of the Volcker Rule).

²⁰ PEGCC Comment Letter in Advance of Proposed Rules, *supra* note 4, at Section I.

sponsored by such firms. Investors typically request (or require) that a private equity firm (or its affiliates and employees) invest in funds being organized by that firm in order to align the interests of that firm with those of the investors.²¹

Furthermore, the PEGCC requests clarification that the definition of “carried interest” in Section 10(b)(ii)(A) was not intended to be limited to carried interest received by banking entities, and that such definition includes carried interest received by any person, including private equity firms (and their affiliates and employees) that sponsor Third Party Private Equity Funds.

Unless Section 13(c) and Section 10(b)(ii)(A) are interpreted as requested above, U.S. private equity firms would be unreasonably restricted from sponsoring, and from competing effectively with non-U.S. private equity firms that sponsor, Third Party Private Equity Funds offered to non-U.S. banking entities without any benefit to the safety and soundness of the non-U.S. banking entities or the financial stability of the United States.

B. *U.S. Offering Restriction*

The PEGCC requests that the Agencies clarify that the restriction on offers and sales to U.S. residents in a Section 13(c) fund applies only to offerings made by banking entities and their employees and not to offerings of Third Party Private Equity Funds made by private equity firms that are not banking entities. In fashioning this marketing restriction, Congress sought to ensure a “level playing field” by prohibiting non-U.S. banking entities from improperly offering hedge fund and private equity fund services to U.S. persons.²² Expanding the offering restriction to cover offering activities of private equity firms that are not banking entities in connection with Third Party Private Equity Funds does not further this purpose or otherwise help ensure the safety and soundness of any banking entities or the financial stability of the United States. In particular, the PEGCC does not believe that investment by U.S. investors that are not banking entities increases the risks faced by non-U.S. banking entities that invest in Third Party Private Equity Funds or otherwise affect the financial stability of the United States. Furthermore, additional compliance burdens would be placed not only on such private equity firms, but also on non-U.S. banking entities investing in Third Party Private Equity Funds, because non-U.S. banking entities do not control the offering activities of the private equity firms offering Third Party Private Equity Funds.

²¹ Such investment may also be desirable for tax reasons.

²² 156 Cong. Rec. S5987 (statement of Sen. Merkley).

C. *Other Interpretations Related to the U.S. Offering Restriction*

1. Offerings Made Prior to the Effective Date

The Proposed Rules reflect the fact that the offering restrictions only apply to offerings made after the effective date of the Volcker Rule.²³ Therefore, the PEGCC believes that a Third Party Private Equity Fund offered only to non-U.S. persons after the effective date of the Volcker Rule would still qualify as a Section 13(c) fund even if U.S. persons were admitted to such Third Party Private Equity Fund prior to the effective date of the Volcker Rule. The PEGCC respectfully requests that the Agencies confirm this straightforward interpretation of the Proposed Rules and the related statutory text in BHC Act Section 13(d)(1)(I) in order to reduce the compliance burdens on private equity firms.

2. Parallel Investment Vehicles

As discussed at the beginning of this Section IV, the PEGCC believes that, to the fullest extent possible and consistent with the statutory language of the Volcker Rule, (i) the extraterritorial application of the Proposed Rules should be limited and (ii) the Proposed Rules should not infringe on the non-U.S. operations of non-U.S. banking entities. Otherwise, the Proposed Rules will have the effect of dictating where non-U.S. banking entities acting offshore may invest their funds, which is a decision that the Dodd-Frank Act leaves to the non-U.S. banking entities' home country regulators. As discussed below, the PEGCC believes that parallel investment vehicles offered only to non-U.S. persons by U.S. or non-U.S. private equity firms are an appropriate and customary means by which non-U.S. banking entities may invest in U.S. and non-U.S. private equity opportunities, consistent with the requirements of the Volcker Rule.

Section 13(c) of the Proposed Rules is clear that non-U.S. banking entities may invest in a Third Party Private Equity Fund so long as no ownership interest in such Third Party Private Equity Fund is offered for sale or sold to a resident of the United States *and* no U.S. subsidiary, affiliate or employee of the banking entity is involved in (*i.e.*, makes or effects) such offer or sale. As discussed in Section IV.B above, the PEGCC believes that the provisions of Section 13(c) that prohibit offering interests in covered funds to U.S. persons if those covered funds are also offered to non-U.S. banking entities should apply only to offers made by non-U.S. banking entities, and not to offers made by private equity firms (that are not banking

²³ Section 13(c)(3)(iii) of the Proposed Rules states “No ownership in such covered fund *is* offered for sale or sold to a resident of the United States” (emphasis added). This language in the Proposed Rules reflects BHC Act Section 13(d)(1)(I), which states “no ownership interest in such hedge fund or private equity fund *is* offered for sale or sold to a resident of the United States” (emphasis added).

entities). However, even if this U.S. offering restriction is deemed by the Agencies to apply to offerings by private equity firms (that are not banking entities) of interests in Third Party Private Equity Funds, the PEGCC believes (i) that the Proposed Rules would permit a private equity firm (that is not a banking entity) to sponsor one or more investment funds offered solely to U.S. persons and certain non-U.S. persons as well as one or more investment funds that satisfy the requirements of Section 13(c) and (ii) that even if those funds invest in parallel (as described below), non-U.S. banking entities would be permitted to invest in the Section 13(c) fund(s).

Private equity firms, and other types of investment firms, in the ordinary course of their businesses, frequently organize (and for decades have organized) so-called “parallel funds”: two or more separate investment entities that typically invest side-by-side and are structured and offered to different types of investors (such as U.S. and non-U.S. investors) to permit and facilitate investment by those investors in private equity investment opportunities.²⁴ The PEGCC believes that the Proposed Rules permit a private equity firm (that is not a banking entity) to organize parallel funds, one or more of which is a Section 13(c) fund, in this manner and that, under the Proposed Rules, non-U.S. banking entities would be permitted to invest in the parallel Section 13(c) fund(s).

The PEGCC believes that this straightforward reading and application of the Proposed Rules furthers the goal, described above, of avoiding unnecessary extraterritorial application of the Volcker Rule to the investment activities of non-U.S. banking entities outside the United States. The PEGCC also believes that this reading and application of the Proposed Rules is appropriate because it eliminates a possible negative impact on the competitive position of U.S. private equity firms (particularly, those whose investors consist primarily of U.S. persons) vis-à-vis their non-U.S. counterparts (particularly, those whose investors consist primarily of non-U.S. persons). Finally, and importantly, the PEGCC believes that this reading and application of the Proposed Rules is appropriate because it would have no negative impact on (i) the safety and soundness of U.S. banking entities, (ii) the safety and soundness of the non-U.S. banking entities that invest in the Section 13(c) fund(s) offered by private equity firms in parallel with other Third Party Private Equity Funds that such firms offer to U.S. investors or (iii) the financial stability of the United States.

²⁴ Parallel funds may or may not be organized in different jurisdictions (such as Delaware and a non-U.S. jurisdiction), or take different forms (e.g., corporations and limited partnerships), or contain somewhat different terms (such as restrictions on investment in certain geographies or types of businesses, or different investor voting arrangements).

3. Definition of Resident of the United States

Finally, the PEGCC requests that the definition of “resident of the United States” for purposes of Section 13(c) funds incorporate the definition of “U.S. person” under Regulation S of the Securities Act of 1933. The Agencies have not provided any explanation of why they have deviated from this definition. Reliance on the Regulation S definition of “U.S. person” has two important advantages: first, there is a well developed body of SEC guidance as to its meaning, and, second, in practice, sponsors of Third Party Private Equity Funds who offer interests in those funds to non-U.S. investors often rely on Regulation S. Therefore, to the extent that sponsors of Third Party Equity Funds are required to monitor whether U.S. persons are admitted to Section 13(c) funds, it would be helpful if such sponsors are not required to monitor multiple definitions of U.S. persons.

* * * * *

The PEGCC appreciates the fact that the Agencies have lengthened the comment period. We note that many U.S. and non-U.S. banking entity investors are awaiting final resolution of the issues relating to the Volcker Rule prior to investing in Third Party Private Equity Funds. Accordingly, the PEGCC urges the Agencies to adopt final implementing rules, with the amendments and clarifications proposed above, in a timeframe that will reduce this period of uncertainty without sacrificing quality and practicality of the final rules.

The PEGCC appreciates the Agencies’ consideration of this letter and is available to discuss any questions that the Agencies may have concerning this letter or the private equity industry generally.

Respectfully submitted,



Steve Judge
President and CEO
Private Equity Growth Capital Council



May 10, 2011

Department of the Treasury
Office of Domestic Finance
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20520

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Board of Governors of the Federal Reserve
System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20551

Securities and Exchange Commission
100 F Street, N.E.
Washington D.C. 20549

**Re: Comment Letter in Advance of Notice of Proposed Rulemaking
Implementing the Private Funds Portion of the Volcker Rule**

Dear Sir or Madam:

We are submitting this letter to the above-named agencies (the “Regulatory Agencies”) in advance of any notice of proposed rulemaking implementing the new Section 13 of the Bank Holding Company Act of 1956 (the “Volcker Rule”) adopted by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).¹ Our comments focus specifically on the potential effects of the Volcker Rule on the ability of private equity funds to raise capital from non-U.S. banks, insurance companies and other investors.

The Private Equity Growth Capital Council (the “PEGCC”) is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 35 of the world’s leading private equity and

¹ Unless otherwise noted, all section references in this comment letter refer to the Dodd-Frank Act.

growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.²

The PEGCC previously submitted comments to the Financial Stability Oversight Council (the “FSOC”) regarding the implementation of the Volcker Rule; a copy of the PEGCC’s prior letter is attached for ease of reference.³ Although the PEGCC’s members are not themselves directly subject to the Volcker Rule, the PEGCC has concerns regarding the application of the Volcker Rule to non-U.S. banks, to insurance company general and separate accounts, to bank-sponsored “customer funds” (under Section 619(d)(1)(G)) and to bank-affiliated pension plans, which are important investors in private equity funds managed by PEGCC member firms.

I. Investments by Non-U.S. Banks

As the Regulatory Agencies know, Congress determined to apply the restrictions of the Volcker Rule to U.S. banking organizations and the U.S. operations of foreign banks that have a U.S. banking presence. Congress was careful, however, to limit the extra-territorial application of the Volcker Rule, choosing deliberately to leave outside the scope of the Volcker Rule’s restrictions the activities conducted by non-U.S. entities outside the United States.

To this end, Section 619(d)(1)(I) specifically allows a non-U.S. banking entity to acquire and retain an interest in a private equity (or hedge) fund if (i) the interest is acquired pursuant to section 4(c)(9) or 4(c)(13) of the Banking Holding Company Act, (ii) the acquisition or retention of an ownership interest in the fund occurs “solely outside the United States,” (iii) there is no offering or sale of interests in the fund to U.S. residents, and (iv) such non-U.S. banking entity is not directly or indirectly controlled by a U.S. banking entity.

The PEGCC believes that these requirements are intended to reflect the extraterritorial boundaries that have long been applied to investment companies under the

² The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; ArcLight Capital Partners; Avista Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; Crestview Partners; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; Irving Place Capital; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

³ See Letter from Douglas Lowenstein, President, PEGCC, to Timothy Geithner, Chairman, FSOC (Nov. 5, 2010).

Investment Company Act of 1940 (the “Investment Company Act”) and the offerings of investment companies under the Securities Act of 1933 (the “Securities Act”). As a general matter, a fund that is not organized in the United States and does not make an offering of its interests in the United States is not subject to the Investment Company Act or the Securities Act (a “Non-U.S. Fund”), regardless of whether the fund receives investment advice from a U.S. person or whether the fund makes investments in the United States.⁴ A similar approach should be taken under Section 619(d)(1)(I). The statute makes no mention of the location of the investment adviser or where a fund makes its investments; instead, the plain language specifies that the acquisition or retention of fund interests occur solely outside the United States. There is no indication in the legislative history that Congress intended to include any restrictions beyond the limitation on offerings and sales to U.S. persons.⁵

Specifically, the PEGCC believes that, under the Volcker Rule, a non-U.S. bank with a U.S. banking presence should be permitted to make a passive, non-controlling investment in a third-party private equity fund that is organized outside of the United States and that did not market its interests to U.S. persons, so long as such non-U.S. bank is not controlled by a U.S. banking entity. In our view, this outcome is compelled for both legal and policy reasons.

First, Section 619(d)(1)(I) reflects a legitimate concern with regard to the extraterritorial application of the Volcker Rule with respect to non-U.S. banking entities. The Dodd-Frank Act generally does not (and is not intended to) apply to the purely non-U.S. operations of non-U.S. banks, which are appropriately governed by their home-country regulatory requirements.⁶ The existing rules and guidance under the Investment Company Act and the Securities Act provide a well-developed body of law for defining which funds should be considered outside the scope of U.S. laws; to the same end, the Federal Reserve’s interpretations under Regulation K and the BHC Act – which have permitted foreign banks to make passive, non-controlling investments in foreign funds that may be managed in and invest in the United States⁷ – provide guidance as to the permissible fund activities of foreign banks. The PEGCC respectfully requests that the

⁴ See Section 7(d) of the Investment Company Act.

⁵ See Statement of Sen. Merkley, 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (the “Merkley Statement”) (mentioning a concern that a non-U.S. bank would “improperly [offer] its hedge fund and private equity fund services to *U.S. persons* when such offering could not be made in the United States”) (emphasis added).

⁶ See Merkley Statement at S5897 (stating that Section 619(d)(1)(I) “recognize[s] rules of international comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law.”)

⁷ Cf. 2 Fed. Res. Reg. Serv. 4-190; accord 12 CFR 225.124.

Regulatory Agencies apply these precedents to permit passive, non-controlling foreign fund investments by non-U.S. banks (even if such funds invest and are managed by third-party managers in the United States).

Second, an unduly restrictive interpretation of the foreign fund/foreign bank provision of the Volcker Rule could severely restrict the flow of capital into U.S. markets, which could have a significant impact on the U.S. economy and U.S. job growth. To explain, many foreign banks make passive, non-controlling investments in funds, including those that invest in the United States. Practically speaking, these banks are unlikely to commit the time and resources to organize funds in accordance with Section 619(d)(1)(G) so that they can continue making fund investments or, alternatively, to invest directly in U.S. companies.⁸ Thus, these non-U.S. banks will have no means to make U.S.-directed investments, which could have an adverse effect on the U.S. economy in general. Indeed, nothing will prevent these non-U.S. banks from investing in non-U.S. funds that invest elsewhere around the world; therefore, the net result of an unduly restrictive interpretation of the Volcker Rule would be to drive investments that could support U.S. jobs and economic growth elsewhere.⁹ In fact, the PEGCC estimates that over \$60 billion in the cumulative capital invested by non-U.S. banks in the U.S. economy through private equity funds could be diverted elsewhere.¹⁰

Third, any restriction relating to the location of an investment adviser to a Non-U.S. Fund would affect the competitiveness of U.S. investment advisers versus non-U.S. investment advisers with no apparent benefit to the safety and soundness of banking entities. Restricting the ability of non-U.S. banks to make investments in private equity funds managed by U.S. investment advisers would most likely result in a shift of those investments to private equity funds that are managed by non-U.S. investment advisers.¹¹

⁸ Many foreign bank investors do not make direct U.S. portfolio company investments but, instead, acquire fund interests to gain exposure to U.S. investment opportunities.

⁹ In addition, one of the congressional concerns underlying the requirements of Section 619(d)(1)(I) was to “maintain a level playing field.” *See* Merkley Statement at S5897. If Section 619(d)(1)(G) is unavailable for practical reasons and the Regulatory Agencies artificially restrict the foreign fund/foreign bank exception, then many foreign banks will be placed at a competitive disadvantage to U.S. banks with the capacity of organizing funds under Section 619(d)(1)(G).

¹⁰ *See* Preqin, 2011 Preqin Global Private Equity Report (2011) (based on estimates of total private equity capital, percentage of capital from investors from outside of North America, percentage of capital from bank or investment bank investors and percentage of capital invested in North America).

¹¹ In addition, there is an absence of an established body of interpretation with regard to whether an investment adviser should be treated as a “U.S. adviser” for these purposes, particularly with regard to non-U.S. entities with U.S. affiliates. The guidance that exists under the Investment Advisers Act of 1940 (the “Advisers Act”) deals with issues of registration under the Advisers Act and would be difficult to apply under these circumstances. *See, e.g.,* Uniao de Bancos de Brasileiros S.A., SEC No- (continued)

The PEGCC respectfully requests that the Regulatory Agencies clarify that a non-U.S. bank with a U.S. banking presence may make passive, non-controlling investments in a Non-U.S. Fund even if such Non-U.S. Fund (1) is advised, managed and/or controlled, directly or indirectly, by a U.S.-based investment manager and/or (2) invests in U.S. portfolio companies.

II. Investments by Insurance Companies

As the FSOC Study noted, “[t]he investment activity of insurers is central to the overall insurance business model and could be unduly disrupted if certain provisions of the Volcker Rule applied.”¹² To fulfill this direction, the PEGCC believes that the Regulatory Agencies should confirm that the exemptions pertaining to (i) investments for insurance company general accounts (“General Accounts”) (Section 619(d)(1)(F)) includes investments in private equity funds and (ii) investments on behalf of customers (Section 619(d)(1)(D)) includes investments in private equity funds for insurance company separate accounts (“Separate Accounts”).

A. *General Accounts*

Through their General Accounts, insurance companies have regularly invested in private equity funds. Private equity investments are particularly valuable for insurance companies in that they have a low historical correlation to the stocks and bonds that comprise the bulk of insurance companies’ investment portfolios and the relatively long-term horizon of private equity funds represent a good portfolio fit for long-dated liability products.

For General Account investment activities of a regulated insurance company, Section 619(d)(1)(F) provides an exemption from the Volcker Rule for investment activities relating to “securities and other instruments described in subsection (h)(4)” that are conducted in compliance with and subject to applicable insurance laws and regulations. Although subsection (h)(4) relates to the definition of term “proprietary trading,” the “securities and other instruments” described in the definition are “any security, any derivative, any contract of sale of a commodity for future delivery, any

Action Letter (July 28, 1992) (discussing under what circumstances a non-U.S. affiliate of a U.S. registered investment adviser must itself register under the Advisers Act). *See also Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers*, SEC Release No. IA-3111 (Nov. 19, 2010) (defining non-U.S. advisers as an adviser whose principal office and place of business is outside of the United States).

¹² *See* FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (Jan. 2011) (the “FSOC Study”) at 71.

option on any such security, derivative, or contract, or any other security or financial instrument, the Securities and Exchange Commission and the Commodity Futures Trading Commission may ... determine.” Interests in private equity funds fall within this description; therefore, the plain language of the statute permits investments in private equity funds by insurance companies through their General Accounts. There is nothing in the legislative history of the Volcker Rule that places any restrictions on the plain language or that would indicate that Congress had any intention to allow only proprietary trading for General Accounts but not investments in hedge funds and private equity funds.

The PEGCC respectfully requests that the Regulatory Agencies confirm what the plain language of the statute says – that interests in private equity funds are a “security” covered by Section 619(h)(4). Such confirmation would ensure that the state laws to which insurance companies are subject are respected and that insurance companies have the flexibility to invest in alternative assets intended by Section 619(d)(1)(F).

B. *Separate Accounts*

A Separate Account is a traditional product established on the books of an insurance company, whereby funds received by the insurance company from a customer under an insurance contract are invested in securities that are earmarked for such customer. Any gains or losses attributable to the securities are for the account of such customer. The customer does not own the underlying assets, but instead owns an insurance contract under which the insurance company’s payment obligations are determined based on the investment performance of the underlying assets. Separate Accounts are used to support a broad range of insurance products.

Congress included Section 619(d)(1)(D), which permits the “purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers.” As stated above, investments by insurance companies with respect to Separate Accounts are made on behalf of customers. The FSOC Study recognized this point in its section relating to insurance companies, but it did not provide any specific direction to the Regulatory Agencies with regard to Separate Accounts except to direct the Regulatory Agencies to “consider how insurance companies invest separately on behalf of customers.”¹³ The PEGCC respectfully requests that the Regulatory Agencies confirm that Separate Accounts are exempted from the Volcker Rule pursuant to Section 619(d)(1)(D).

¹³ See the FSOC Study at 74.

III. Other Issues

The PEGCC also wishes to reiterate its prior comments regarding the definition of “banking entity” and, specifically, the ability of so-called “customer funds,” under Section 619(d)(1)(G), and bank-affiliated pension funds to invest in private equity funds.¹⁴

The PEGCC is concerned that an overly expansive definition of “banking entity” could prohibit bank-sponsored “customer funds” relying on Section 619(d)(1)(G) from investing in funds that are controlled and/or managed by third-party private equity firms (such as the PEGCC’s members) that are not affiliated with the banking entity sponsoring the customer fund (“Third Party Funds”).¹⁵ Such a prohibition would contradict the clear intent of Section 619(d)(1)(G), would not advance the goals of the Volcker Rule and would serve only to limit bank clients’ access to the investment opportunities provided by leading Third Party Funds. The PEGCC respectfully requests the Regulatory Agencies permit customer funds to invest in any asset classes, including Third Party Funds.

The PEGCC also is concerned that an overly broad definition of “banking entity” could mistakenly capture certain bank-affiliated pension plans. Many banking organizations organize, sponsor and maintain tax-qualified pension plans for their own employees subject to the Employee Retirement Income Security Act of 1974 (“ERISA”), which sets forth a statutory framework to ensure that a pension plan’s assets are invested for the exclusive benefit of its participants and beneficiaries (“Bank Pension Plans”). Any interpretation that a Bank Pension Plan is a “banking entity” for purposes of the Volcker Rule would apply a drastic and unintended blanket prohibition on Bank Pension Plans investing in Third Party Funds, which would unduly deny Bank Pension Plans the diversification and return potential afforded by such investments. Additional restraints on fiduciaries to Bank Pension Plans are not necessary due to ERISA’s carefully delineated framework. Finally, the investments of Bank Pension Plans do not create any of the conflicts of interest that the Volcker Rule seeks to eliminate. For all these reasons, the PEGCC respectfully requests that the Regulatory Agencies confirm that the Volcker Rule does not prohibit a Bank Pension Plan from investing in Third Party Funds.

¹⁴ The PEGCC notes that the FSOC Study specifically recommended that the Regulatory Agencies “carefully consider the impact of certain [Bank Holding Company Act] definitions on the Volcker Rule’s definition of ‘banking entity’ and implement that term in a way that avoids results that Congress clearly did not intend in enacting the Volcker Rule.” The FSOC Study at 68–69.

¹⁵ We note that some banks have units that form, administer and/or control feeder vehicles to facilitate investment by the bank’s high net worth private banking or other clients in Third Party Funds. These feeder vehicles reduce the administrative burden on investors and enable banks to provide their clients with access to leading Third Party Funds.

* * * * *

The PEGCC appreciates the opportunity to comment in advance of the proposed rules and would be pleased to answer any questions you might have regarding our comments, or regarding the private equity and growth capital industry more generally.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Douglas Lowenstein". The signature is fluid and cursive, with a long horizontal stroke at the end.

Douglas Lowenstein
President
Private Equity Growth Capital Council



SUBMITTED ELECTRONICALLY

November 5, 2010

The Honorable Timothy F. Geithner
Secretary, United States Department of the Treasury
Chairman, Financial Stability Oversight Council
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Financial Stability Oversight Council Request for Public Input for the Study Regarding Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds – FSOC-2010-0002

Dear Secretary Geithner:

These comments are submitted by the Private Equity Growth Capital Council (the “PEGCC”). The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 32 of the world’s best-known and most respected private equity and growth capital firms, united by their commitment to growing and strengthening the businesses in which they invest.¹

The PEGCC appreciates the opportunity to submit comments for consideration by the Financial Stability Oversight Council (the “FSOC”) members with respect to the Request for Public Input for the Study Regarding Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds as provided for in Section 619 of the recently enacted Dodd-Frank Wall Street

¹ The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; Avista Capital Partners; Bain Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; Crestview Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

Reform and Consumer Protection Act (the “Dodd-Frank Act”). All Section references herein are to the Dodd-Frank Act, unless otherwise indicated.

Although the PEGCC’s members are not themselves directly subject to the Volcker Rule, the PEGCC has concerns regarding (1) the potential application of the Volcker Rule to bank-affiliated feeder funds and pension plans, insurance company general accounts and separately managed accounts, and non-U.S. banking entities; and (2) the transition period for compliance with the Volcker Rule.

Framework for Our Responses to the Request for Public Input

Section 619 amends the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) (the “BHC Act”) by adding a new Section 13, which is commonly known and referred to herein as the “Volcker Rule” and which is to be implemented by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodity Futures Trading Commission (collectively, the “Regulatory Agencies”). The Volcker Rule generally restricts banking entities from engaging in proprietary trading and from investing in private equity funds and hedge funds. Our comments focus on the Volcker Rule’s restrictions on investments in private equity funds.

Before responding below to individual questions in the request for public input, the PEGCC wishes to propose the following overarching framework, which guides its responses:

(1) The purpose of the Volcker Rule is not to limit the ability of the private equity industry to raise and invest capital, but to promote the safety and soundness of banking entities and to reduce conflicts of interest between banking entities and their customers. The Volcker Rule should be applied to the extent necessary to ensure the safety and soundness of the banking system and to reduce such conflicts of interest, while avoiding an overbroad application that could unnecessarily impede private investment and economic growth.

(2) Banks and insurance companies provide a wide range of intermediary services to clients. Congress did not intend to prohibit these intermediary services, and the Volcker Rule should not be construed to restrict private equity investment where a banking entity serves as an intermediary.

(3) Under the Volcker Rule, a foreign banking entity with a U.S. presence is allowed to invest in a private equity fund “solely outside of the United States,” provided that no interest in such private equity fund is offered for sale or sold to U.S. residents and the foreign banking entity is not controlled by a U.S. banking entity. Such foreign banking entities should not be prohibited from investing in a private equity fund that is

established outside of the United States, the interests of which are not offered or sold to U.S. residents, even if such private equity fund may invest in U.S. assets and/or such private equity fund is advised, managed and/or controlled, directly or indirectly, by a U.S. entity (such as a U.S. private equity firm) that is not a banking entity.

(4) Given the illiquid nature of private equity fund investments, the difficulty of transferring interests in private equity funds and the significant percentage of private equity fund interests that are owned by banking entities, the deadline for banks to dispose of interests in private equity funds should be extended to the maximum extent allowable. Such an approach would serve to enhance the safety and soundness of banks that currently own private equity interests and minimize disruption in the marketplace more generally.

Our Responses to the Request for Public Input

1. Commenters are invited to submit views on ways in which the implementation of the Volcker Rule can best serve to:

[Text of (i)–(v) deleted.]

- (vi) Appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system; and**

Please see our response to question 3 below.

- (vii) Appropriately time the divestiture of illiquid assets that are affected by the implementation of the prohibitions under the Volcker Rule.**

Please see our response to question 11 below.

3. What are the key factors and considerations that should be taken into account in making recommendations on implementing the provisions of the Volcker Rule that restrict the ability of banking entities to invest in, sponsor or have certain other covered relationships with private equity and hedge funds?

The key considerations in implementing the Volcker Rule restriction on the ability of banking entities to invest in private equity funds should be as set forth in the introduction above, namely, complying with the letter and intent of the Volcker Rule while not unduly impairing banking entities and the U.S. economy. The PEGCC believes

that this approach generally should result in the restrictions of the Volcker Rule being interpreted and construed narrowly. For example, the PEGCC believes that the following activities were not meant to be prohibited by the Volcker Rule, and suggests that the FSOC recommend such treatment to the Regulatory Agencies:

(1) Fiduciary Funds. Under the Volcker Rule, banking entities are allowed to sponsor private equity funds, subject to certain restrictions, pursuant to Section 619(d)(1)(G) (a “Fiduciary Fund”). The Volcker Rule imposes no restrictions on the types of assets that a Fiduciary Fund may acquire. The PEGCC is concerned that the definition of “banking entity” could be inappropriately construed so as to prohibit Fiduciary Funds from investing in private equity funds that are controlled and/or managed by private equity firms (such as the PEGCC’s members) that are not affiliated with the banking entity sponsoring the Fiduciary Fund (“Third-Party Funds”).²

Section 619(h)(1) defines “banking entity” as “any insured depository institution...and any affiliate or subsidiary of any such entity.”³ A Fiduciary Fund is likely to be a subsidiary of the sponsoring bank⁴ such that, as a technical matter, each Fiduciary Fund could be deemed to be a “banking entity,” and thereby be prohibited from investing in Third-Party Funds. Such a prohibition would contradict the clear intent of Section 619(d)(1)(G), would not advance the goals of the Volcker Rule and would serve only to limit the access of bank clients to the economic benefits of being associated with leading Third Party Funds.

Congress did not limit the asset classes in which a Fiduciary Fund may invest under the Volcker Rule, and an overly technical reading of the “banking entity” definition

² We note that some banks have units that form, administer and/or control feeder vehicles to facilitate investment by the bank’s high net worth private banking or other clients in Third Party Funds. These feeder vehicles reduce the administrative burden on investors and enable banks to provide their clients with access to leading Third Party Funds.

³ The full definition is: “The term ‘banking entity’ means any insured depository institution (as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity.” Section 619(h)(1).

⁴ The BHC Act defines “subsidiary” as, with respect to a specified bank holding company, “(1) any company 25 per centum or more of whose voting shares (excluding shares owned by the United States or by any company wholly owned by the United States) is directly or indirectly owned or controlled by such bank holding company, or is held by it with power to vote; (2) any company the election of a majority of whose directors is controlled in any manner by such bank holding company; or (3) any company with respect to the management or policies of which such bank holding company has the power, directly or indirectly, to exercise a controlling influence, as determined by the Board, after notice and opportunity for hearing.”

should not impose such a limit. The PEGCC respectfully requests that the FSOC recommend that the Regulatory Agencies permit Fiduciary Funds to invest in any asset classes, including Third-Party Funds.

(2) Bank-Affiliated Pension Plans. Many banking enterprises organize, sponsor and maintain tax-qualified pension plans for their own employees (“Bank Pension Plans”). These plans are subject to the Employee Retirement Income Security Act of 1974 (“ERISA”), which sets forth a statutory framework to ensure that a pension plan’s assets are invested for the exclusive benefit of its participants and beneficiaries.⁵ Because Bank Pension Plans may be deemed to be controlled by or affiliated with insured depository institutions, there is a risk that they would be deemed to be “banking entities” for Volcker Rule purposes. Similarly, under Section 2(g)(2) of the BHC Act, shares held or controlled, directly or indirectly, by pension plan trustees for the benefit of the employees of a company may be deemed to be controlled by the company. As a result, even if a Bank Pension Plan were not deemed to be a “banking entity,” investments made by the Bank Pension Plan could be attributed to the affiliated bank, which would limit the investments the Bank Pension Plan could make to those which the affiliated bank itself is able to make.

Either of these technical readings would apply a drastic and unintended blanket prohibition on Bank Pension Plans investing in Third-Party Funds, which would unduly deny Bank Pension Plans the diversification and return potential afforded by such investments. Moreover, additional restraints on fiduciaries to Bank Pension Plans are not necessary due to ERISA’s carefully delineated legislative framework. Given the restrictions already imposed by ERISA, fiduciaries of Bank Pension Funds would be better served if they had the same array of investment options as other prudent investment professionals managing pension monies. Finally, the investments of Bank Pension Plans do not create any of the conflicts of interest that the Volcker Rule seeks to eliminate. For all these reasons, the PEGCC therefore respectfully requests that the FSOC recommend that the Regulatory Agencies clarify that the Volcker Rule does not prohibit a Bank Pension Plan from investing in Third-Party Funds.

(3) Insurance Company General Accounts. Insurance companies investing their general accounts regularly invest a portion of their general accounts in private equity

⁵ ERISA imposes on plan fiduciaries duties that are commonly understood to be “the highest known to the law” including: (1) the “prudent man” standard, which requires that a fiduciary invest plan assets under the same standard as a prudent investment professional managing retirement monies; (2) the requirement to diversify so as to minimize the risk of large losses (unless under the circumstances it is clearly prudent not to do so); and (3) the exclusive benefit rule, which requires that a fiduciary act solely in the interest of the participants and beneficiaries. ERISA also prohibits a fiduciary from dealing with the assets of a plan for its own benefit. Under this statutory framework, while in general a pension plan may invest in private equity funds, such investments are not permitted when they are made to further the business objectives of the sponsor bank or its clients.

funds. Private equity investments are particularly valuable for insurance companies in that they have a low historical correlation to the stocks and bonds that comprise the bulk of insurance companies' investment portfolios and the relatively long-term horizon of private equity funds represent a good portfolio fit for long-dated liability products.

All insurance company investments are subject to extensive state insurance laws, which impose both qualitative and quantitative limits on insurance companies. In light of this stringent state framework, throughout the Dodd-Frank Act, Congress often declined to impose new federal laws on insurance companies (including those that are "banking entities" under the Volcker Rule). Recognizing the importance of giving flexibility to insurance companies to invest their general accounts, Congress included Section 619(d)(1)(F), which allows a regulated insurance company investing the general account of the insurance company to acquire "any security" as described in Section 619(h)(4).

The PEGCC respectfully requests that the FSOC recommend that the Regulatory Agencies clarify that interests in private equity funds are a "security" covered by Section 619(h)(4), to eliminate any confusion that might exist due to the fact that Section 619(h)(4) is titled "Proprietary Trading." Such clarification would ensure that the state laws to which insurance companies are subject are respected and that insurance companies have the flexibility to invest in alternative assets intended by Section 619(d)(1)(F).

(4) Insurance Company Separate Accounts. A separate account is a traditional product established on the books of an insurance company, whereby funds received by the insurance company from a customer under an insurance contract are invested in securities that are earmarked for such customer. Any gains or losses attributable to the securities are for the account of such customer. The customer does not own the underlying assets, but instead owns an insurance contract under which the insurance company's payment obligations are determined based on the investment performance of the underlying assets. Separate accounts are used to support a broad range of insurance products.

This type of intermediary activity is clearly not meant to be prohibited by the Volcker Rule. Congress included Section 619(d)(1)(D), which permits the "purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers." As stated above, ultimately the investments by insurance companies with respect to separate accounts are made on behalf of customers. The PEGCC respectfully requests that the FSOC recommend that the Regulatory Agencies clarify that insurance company separate accounts are exempted from the Volcker Rule pursuant to Section 619(d)(1)(D).

10. How should the international context be considered when implementing the Volcker Rule? Are there any factors or considerations that should be taken into account regarding the application of the Volcker Rule to banking

entities or nonbank financial companies that operate outside the United States? What issues does implementation of the Volcker Rule present with respect to the following:

- (i) Domestic banking entities that have access to foreign exchanges,**
- (ii) foreign affiliates of domestic banking entities, and**
- (iii) foreign non-bank financial companies**

A foreign banking entity that has a U.S. banking presence is subject to restrictions under the Volcker Rule, but Section 619(d)(1)(I) allows such a foreign banking entity to acquire or retain an interest in a private equity fund “solely outside of the United States,” provided that no ownership interest in such private equity fund is offered for sale or sold to a U.S. resident *and* that such foreign banking entity is not controlled by a U.S. banking entity (such foreign banking entity, a “Non-U.S. Banking Entity”). The PEGCC understands that this exemption permits a Non-U.S. Banking Entity to invest in any private equity fund that is formed under the laws of a country other than the United States so long as no interest in such private equity fund is offered for sale or sold to a U.S. resident (a “Non-U.S. Private Equity Fund”). The PEGCC respectfully requests that the FSOC recommend that the Regulatory Agencies clarify that a Non-U.S. Banking Entity may invest in a Non-U.S. Private Equity Fund even if such Non-U.S. Private Equity Fund (1) is advised, managed and/or controlled, directly or indirectly, by a U.S.-based investment manager and/or (2) invests in assets in the United States.

11. What timing issues are raised in connection with the divestiture of illiquid assets affected by the prohibitions of the Volcker Rule, and how might such issues be appropriately addressed?

Private equity funds generally invest in highly illiquid assets—typically unlisted securities of operating companies. Unlike investors in hedge funds, investors in private equity funds do not have redemption or withdrawal rights. There is no active secondary market for interests in private equity funds. Transfers of private equity fund interests are subject to GP approval and tend to be highly negotiated. Adding to the difficulty of selling a private equity fund interest is the fact that many of the likely purchasers are now covered by the Volcker Rule. Most private equity funds have terms of ten years, with potential extensions of one to three years with the consent of at least a majority in interest (by amount of capital commitments) of investors or the consent of an investor advisory committee. For private equity funds that had an initial closing in early 2010, investors’ capital generally will be locked-up until 2021–2023.

Banks represent approximately 5% of investors in U.S. private equity funds and investments by banks represent approximately 9% of the capital invested in U.S. private

equity funds.⁶ Given the size of investments in private equity by banking entities, it could threaten the safety and soundness of banking entities and create significant market disruption if banking entities are required to sell their interests in private equity funds prior to the end of the terms of the private equity funds in which they are now invested. In recognition of this threat, Section 619(c)(3) allows the Federal Reserve Board to extend the transition period for a banking entity by up to five years with respect to its interests in “illiquid funds.” Given that many funds formed in early 2010 will not terminate until 2022 or 2023, the PEGCC respectfully requests that the FSOC recommend that the Federal Reserve Board clarify that any extended transition for illiquid funds granted under Section 619(c)(3) shall be in addition to any extension of the conformance period under Section 619(c)(2), which would allow the Federal Reserve Board the flexibility to grant extensions until the end of the term of most private equity funds that were formed before the Dodd-Frank Act was passed.

* * *

The PEGCC appreciates the FSOC’s consideration of our views, and is ready and available to respond to any questions that the FSOC may have concerning this letter or that otherwise may develop concerning the private equity industry.

Respectfully submitted,



Douglas Lowenstein
President
Private Equity Growth Capital Council

cc: Mr. Alastair Fitzpayne
Deputy Chief of Staff and Executive Secretary
United States Department of the Treasury

⁶ Source: Preqin press release, *Effects of Obama’s Proposal on Alternatives Industry Significant* (January 22, 2010).