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THE FINANCIAL SERVICES ROUNDTABLE
Financing America's Economy

American Bankers Association
Building Success. Together.

March 9, 2012

By electronic submission

Re: Supplemental Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – **Hedge Funds and Private Equity Funds**

The Securities Industry and Financial Markets Association, the American Bankers Association, The Financial Services Roundtable and The Clearing House Association appreciate the opportunity to comment on the "covered funds" portion of the proposed rules issued by the Agencies[1] implementing new Section 13 of the Bank Holding Company Act of 1956 (the "**Volcker Rule**").

This comment letter, which supplements our comment letter filed with the Agencies on February 13, 2012 (our "**Funds Letter**"),[2] responds to certain specific requests for comment in the covered funds portions of the proposed rules. Although in most instances our responses mirror the recommendations in our Funds Letter, we have supplemented those recommendations in response to certain questions.[3]

The Funds Letter does not address the proprietary trading portion of the proposed rules, except to the extent it argues that the general prohibitions on investing in and having certain relationships with covered funds should be subject to the same exemptions for underwriting, market making-related activities and risk-mitigating hedging as the general prohibition on proprietary trading. Nor does it address the extent to which the proposed rules may disrupt or

[1] The Agencies are the Office of the Comptroller of the Currency ("**OCC**"), the Board of Governors of the Federal Reserve System ("**Board**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Securities and Exchange Commission ("**SEC**") and the Commodity Futures Trading Commission ("**CFTC**"). The rule identifiers are ***OCC*** Docket ID 2011-14 & RIN 1557-AD44; ***FRB*** Docket No. R-14 & RIN 7100 AD; ***FDIC*** RIN 3064-AD85; ***SEC*** File No. S7-41-11 & RIN 3235-AL07; ***CFTC*** RIN 3083-AD05.

[2] *See* SIFMA Funds Letter (Feb. 13, 2012), available at http://www.sifma.org/issues/item.aspx?id=8589937355.

[3] *Id*. at 2.

otherwise interfere with the securitization or municipal securities markets. SIFMA has submitted separate letters on proprietary trading, securitization and municipal securities issues.[4]

[4] For our main discussion of the proprietary trading provisions of the Volcker Rule, please see our comment letter on proprietary trading (Feb. 13, 2012), available at http://www.sifma.org/issues/item.aspx?id=8589937353. For a discussion of the impact of the proprietary trading provisions of the proposed rules on liquidity for customers of U.S. asset managers, please see our Asset Management Group's comment letter on proprietary trading (Feb. 13, 2012), available at http://www.sifma.org/issues/item.aspx?id=8589937354. For a discussion of the impact of the proposed rules on securitization and insurance-linked securities, please see our Securitization Group's comment letter (Feb. 13, 2012), available at http://www.sifma.org/issues/item.aspx?id=8589937357. For a discussion of the impact of the proposed rules on municipal securities and tender option bonds, please see our Municipal Securities Division's comment letter (Feb. 13, 2012), available at http://www.sifma.org/issues/item.aspx?id=8589937356.

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We thank the Agencies for their consideration of our comments. If you have any questions, please do not hesitate to call Randall D. Guynn, Davis Polk & Wardwell LLP, at 212-450-4239.

Sincerely,

Securities Industry and Financial Markets Association
American Bankers Association
The Financial Services Roundtable
The Clearing House Association

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RESPONSES TO SPECIFIC REQUESTS FOR COMMENT

1. **Section __.1: Authority, purpose, scope and relationship to other authorities**

   b. **Effective date**

- **Question 1. Does the proposed effective date provide banking entities with sufficient time to prepare to comply with the prohibitions and restrictions on proprietary trading and covered fund activities and investments? If not, what other period of time is needed and why?**

No, we do not believe that the proposed effective date provides banking entities with sufficient time to prepare to comply with the prohibitions and restrictions on covered fund activities and investments. For the reasons provided in Sections VIII.B (C-115) and IX. (C-118) of our Funds Letter, we recommend the following changes:

1. Compliance Timing. The Agencies should clarify that banking entities will have at least one year following issuance of the final rules to develop and implement compliance programs.

2. Conformance Period.

i. Extended Conformance Period. Because the Agencies were unable to issue final rules implementing the Volcker Rule before the statutory deadline in October 2011, the Board should delay the effective date of the statute until one year after the later of July 21, 2012 and the date on which final rules become effective. Alternatively, the Board should grant a general one-year extension of the conformance period to all covered banking entities in advance.

ii. Non-Funds and Similar Funds. The Board should amend its conformance rules to permit banking entities to continue sponsoring or investing in, or entering into new covered transactions with, a related entity that (i) may fall within the term "covered fund," but is not a genuine hedge fund or private equity fund as commonly understood as set forth in Annex B of our Funds Letter or (ii) is a designated similar fund, for the duration of the conformance period.

iii. New Covered Transactions. The Board should clarify that a banking entity may, during the conformance period, continue to enter into new covered transactions with a covered fund that was established before the effective date of the statute.

iv. Illiquid Funds. The Board should amend its conformance rules to provide a meaningful extended conformance period for illiquid funds.

- **Question 2. Does the proposed effective date provide banking entities with sufficient time to implement the proposal's compliance program requirement? If not, what**

are the impediments to implementing specific elements of the compliance program and what would be a more effective time period for implementing each element and why?

No, we do not believe that the proposed effective date provides banking entities with sufficient time to implement the proposal's compliance program requirement. Please see our response to Question 1.

- **Question 3. Does the proposed effective date provide banking entities sufficient time to implement the proposal's reporting and recordkeeping requirements? If not, what are the impediments to implementing specific elements of the proposed reporting and recordkeeping requirements and what would be a more effective time period for implementing each element and why?**

No, we do not believe that the proposed effective date provides banking entities sufficient time to implement the proposal's reporting and recordkeeping requirements. Please see our response to Question 1.

- **Question 4. Should the Agencies use a gradual, phased in approach to implement the statute rather than having the implementing rules become effective at one time? If so, what prohibitions and restrictions should be implemented first? Please explain.**

Yes, the Agencies should use a gradual, phased in approach to implement the statute rather than having the implementing rules become effective at one time. Please see our response to Question 1.

2. Section __.2: Definitions

- **Question 5. Is the proposed rule's definition of banking entity effective? What alternative definitions might be more effective in light of the language and purpose of the statute?**

No, we do not believe that the proposed rule's definition of banking entity is effective. For the reasons provided in Section V (C-43) of our Funds Letter, we recommend the following changes:

1. Banking Entity. For purposes of the term "banking entity," the terms "subsidiary" and "control" should be defined as set forth in Section 2 of the BHC Act, but in each case without the "controlling influence" prong.

2. Exclusions. The following entities should be excluded from the term "banking entity":

   i. Permitted Covered Funds. All covered funds that a banking entity is permitted to sponsor or invest in under any "permitted activity" exemption, including the asset management exemption;

   ii. Exempt Funds. All issuers that would be investment companies under the 1940 Act, except that they qualify for an exemption under any provision of that Act other than Sections 3(c)(1) or 3(c)(7) of that Act;

iii. SEC-Registered Investment Companies and BDCs. All SEC-registered investment companies and business development companies;

iv. Public Commodity Pools. All commodity pools that have made a public offering of their securities and have not been taken private;

v. Public Foreign Funds. All foreign funds that either (i) have made a public offering of their securities and have not been taken private or (ii) are eligible to make a public offering and are subject to regulation of their investments and activities;

vi. Portfolio Companies. All portfolio companies held by a BHC under the merchant banking authority of Section 4(k)(4)(H) of the BHC Act or by any other type of depository institution holding company in accordance with applicable law;

vii. Temporarily Grandfathered Covered Funds. All covered funds established before the effective date of the Volcker Rule, but only for the duration of the conformance period;

viii. Subsidiaries. All direct or indirect subsidiaries of any of the foregoing; and

ix. Investment Management Affiliates. Solely for purposes of the name sharing condition in the asset management exemption, all investment management affiliates should be excluded from the definition of "banking entity," provided that such investment management affiliates do not share a name with an insured depository institution affiliate or the ultimate parent of such an insured depository institution affiliate.

In addition, please see our comments in Section VI.B.(2)(a) (C-66) of our Funds Letter on the materially negative impact that the attribution rules in § __.12 of the proposed rules could have on banking entities' asset management businesses, including their fund of funds businesses and their ability to employ master-feeder and parallel fund structures, should the definition of "banking entity" not be modified as we recommend.

- **Question 6. Are there any entities that should not be included within the definition of banking entity since their inclusion would not be consistent with the language or purpose of the statute or could otherwise produce unintended results? Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not?**

Yes, there are entities that should not be included within the definition of banking entity. In particular, a registered investment company should be excluded from the definition of banking entity. Please see our response to Question 5 for other entities that should be excluded from the definition of banking entity and the reasons why.

- **Question 7. Is the proposed rule's exclusion of a covered fund that is organized, offered and held by a banking entity from the definition of banking entity effective? Should the definition of banking entity be modified to exclude any covered fund? Why or why not?**

Yes, the proposed rule's exclusion of a covered fund that is organized, offered and held by a banking entity from the definition of banking entity is effective and appropriate. But we believe that the definition of the term "banking entity" should be modified to exclude any covered fund that a banking entity is permitted to sponsor or invest in under any "permitted activity" exemption. Please see our response to Question 5 for the reasons why.

- **Question 8. Banking entities commonly structure their registered investment company relationships and investments such that the registered investment company is not considered an affiliate or subsidiary of the banking entity. Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not? Are there circumstances in which such companies should be treated as banking entities subject to section 13 of the BHC Act? How many such companies would be covered by the proposed definition?**

Yes, a registered investment company should be expressly excluded from the definition of banking entity. We note that although banking entities may sometimes structure their registered investment company relationships and investments such that the registered investment company is not considered an affiliate or subsidiary of the banking entity, this is not always the case (*e.g.*, where a banking entity owns 5% or more of a class of voting securities of a registered investment company and also serves as investment adviser to the registered investment company). Indeed, we believe that a substantial number of registered investment companies would be deemed to be controlled by a substantial number of bank holding companies under the Federal Reserve's control rules under the BHC Act. Please see our responses to Questions 5 and 6 for further information about the reasons why registered investment companies should be excluded from the term "banking entity."

- **Question 8.1. What is the best method for the CFTC and the other regulators to coordinate regarding the allocation of supervisory responsibilities under the proposed CFTC Rule?**

Please see Section VIII.A. (C-114) of our Funds Letter for our recommendations regarding the best method for the CFTC and the other regulators to coordinate regarding the allocation of supervisory responsibilities under the proposed rules. Our recommendations include the following:

1. Interpretation. The Board should have exclusive authority to interpret the Volcker Rule and the Proposed Rules;

2. Examinations. Where more than one Agency has examination authority over a given banking entity, the Agencies should ensure that any examination of the banking entity under the Volcker Rule will be done on a coordinated basis by the Agencies concerned;

3. Enforcement. No enforcement action should be initiated by an Agency under the Volcker Rule unless done on a coordinated basis with all the Agencies.

C. Subpart C — Covered Fund Activities and Investments

1. Section __.10: Prohibition of acquisition or retention of ownership interests in, and certain relationships with, a covered fund

b. "Covered fund" and related definitions

- **Question 215. Is the proposed rule's approach to applying section 13 of the BHC Act's restrictions related to covered fund activities and investments to those instances where a banking entity acts "as principal or beneficial owner" effective? If not, why? What alternative approach might be more effective in light of the language and purpose of the statute?**

Yes, the proposed rule's approach to applying section 13 of the BHC Act's restrictions related to covered fund activities and investments to those instances where a banking entity acts "as principal or beneficial owner" is effective. We believe that the proposed rule's recognition that the assets of a qualified pension plan by law do not belong to the sponsor of the plan and must be used solely for the benefit of participants and their beneficiaries is particularly important. Under that law, the Employee Retirement Income Security Act of 1974 or "ERISA," the fiduciaries of banking entities' pension plans, which, of necessity, must include employees of the plan sponsor, are subject to a comprehensive legal system regulating their conduct, including a legal obligation to avoid having a pension plan engage in various kinds of transactions with related parties and others. The "as principal" approach provides the fiduciaries of a financial institution's pension plan with the same opportunity (subject to their obligations under ERISA) that fiduciaries of non-bank pension plans have to invest pension plan assets in covered funds and otherwise provide services to pension plans, whether through affiliated or unaffiliated service providers, without being concerned that doing so might be in violation of the Volcker Rule or that it might inadvertently subject such covered funds or other investments to the Volcker Rule.

- **Question 216. Does the proposed rule effectively address the circumstances under which an investment by a director or employee of a banking entity in a covered fund would be attributed to a banking entity? If not, why? What alternative might be more effective?**

Although the proposed rule in large part effectively addresses the circumstances under which an investment by a director or employee of a banking entity in a covered fund would be attributed to a banking entity, for the reasons provided in Section VI.B.(3) (C-74) of our Funds Letter, we have the following observation and recommendation:

1. Employee and Director Investments. Investments permissibly made by a director or employee directly engaged in providing investment advisory or other services to a covered fund organized and offered or sponsored under the asset management exemption should not become impermissible (and therefore attributed to the banking entity) solely because the

director or employee ceases to provide such services, absent evidence of an intent to evade the prohibitions of the Volcker Rule.

- **Question 217. Does the proposed rule's definition of "covered fund" effectively implement the statute? What alternative definitions might be more effective in light of the language and purpose of the statute?**

No, the proposed rule's definition of "covered fund" does not effectively implement the statute. For the reasons provided in Section IV (C-12) of our Funds Letter, we recommend the following changes:

1. Exclusion from Covered Fund.

    i. Duty and Authority. The Agencies have a duty and the authority to define "covered fund" in a way that excludes ordinary corporate structures that have never been considered hedge funds or private equity funds, such as wholly owned subsidiaries, joint ventures and acquisition vehicles.

2. Proposed Regulatory Definitions.

    i. Covered Fund. The term "covered fund" should be defined as a "hedge fund," "private equity fund" or "designated similar fund" (*i.e.*, a "similar commodity pool" or "similar foreign fund," as defined in our Funds Letter) to maintain the distinctions between these different types of covered funds.

    ii. Hedge Fund. The term "hedge fund" should be defined as any issuer that both (A) would be an investment company under the Investment Company Act of 1940 (the "1940 Act") but for Sections 3(c)(1) or 3(c)(7) of that Act and (B) has all of the characteristics of a hedge fund as commonly understood, as set forth in Annex B of our Funds Letter.

    iii. Private Equity Fund. The term "private equity fund" should be defined as any issuer that both (A) would be an investment company under the 1940 Act but for Sections 3(c)(1) or 3(c)(7) of that Act and (B) has all of the characteristics of a private equity fund as commonly understood, as set forth in Annex B of our Funds Letter.

3. Excluded Entities. The Agencies should define the term "covered fund" in a manner that excludes any issuer that is a wholly owned subsidiary, joint venture, acquisition vehicle, SEC-registered investment company or business development company, financial market utility and any other issuer that is designated as an excluded entity by rule or order of the Agency that is a banking entity's primary federal financial regulator.

    i. Wholly Owned Subsidiaries. The Agencies should exclude all wholly owned subsidiaries from the term "covered fund."

ii. Joint Ventures.

(A) Operating Company Condition. The Agencies should eliminate the "operating company" condition in the definition of "joint venture."

(B) Proposed Definition. Instead, they should define the term "joint venture" as any company with (i) a limited number of co-venturers and (ii) management pursuant to a shareholders' agreement among the co-venturers, rather than management by a general partner or similar entity.

(C) Operating Company Definition. If the Agencies retain the "operating company" condition, the term "operating company" should be defined as any company engaged in activities that are permissible for a financial holding company under Sections 3 or 4 of the BHC Act, other than being a company engaged exclusively in investing in the securities of other companies for resale or other disposition.

iii. Acquisition Vehicles. The Agencies should exclude acquisition vehicles from the term "covered fund" so that such entities are not treated as covered funds under the Volcker Rule for any purpose, including Super 23A.

iv. SEC-Registered Investment Companies and BDCs. The Agencies should exclude SEC-registered investment companies and business development companies from the definition of "covered fund."

v. Financial Market Utilities. The Agencies should exclude financial market utilities from the definition of "covered fund."

vi. Other Excluded Entities. The Agencies should include a mechanism in the Proposed Rules that would permit the Agencies to exclude other categories of entities from the term "covered fund" by rule or order.

Please also see our responses to Questions 218 and 224, respectively, regarding our recommendations for limiting the range of commodity pools and foreign funds that are treated as similar funds.

- **Question 218. Is specific inclusion of commodity pools within the definition of "covered fund" effective and consistent with the language and purpose of the statute? Why or why not?**

No, the specific inclusion of commodity pools within the definition of "covered fund" is neither effective nor consistent with the language and purpose of the statute. For the reasons provided in Section IV.B.(1) (C-31) of our Funds Letter, we recommend the following change:

1. Similar Commodity Pools. The term "similar commodity pool" should be defined as any commodity pool, as defined in the Commodity Exchange Act (the "CEA"), that satisfies *all* of the following conditions:

i. it is engaged primarily in trading commodity interests; and

ii. it does not make a public offering of its securities; and

iii. its securities are beneficially owned by no more than 100 persons or exclusively by qualified purchasers (as defined in the 1940 Act); and

iv. it has all of the characteristics of a hedge fund or private equity fund as set forth on Annex B of our Funds Letter; and

v. it is not an Excluded Entity (as defined in our response to Question 217), an Exempt Entity (as defined below) or an exchange traded fund (ETF).

- **Question 218.1. The proposed CFTC Rule defines a "covered fund" to include a commodity pool, as defined in section 1a(1) of the Commodity Exchange Act. Is the use of this definition of "commodity pools" too broad? For example, will this definition pull in additional pools that are not registered with the CFTC?**

Yes, the use of the term "commodity pools" would sweep in entities that are not similar to a hedge fund or private equity fund and therefore exceeds the CFTC's statutory authority under the Volcker Rule. Please see our response to Question 218.

- **Question 221. Should the definition of "covered fund" focus on the characteristics of an entity rather than whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act? If so, what characteristics should be considered and why? Would a definition focusing on an entity's characteristics rather than its form be consistent with the language and purpose of the statute?**

Yes, for the reasons provided in Section IV (C-12) of our Funds Letter, we believe that the Agencies have a duty and the authority to define "covered fund" in a way that focuses on the characteristics of a hedge fund and private equity fund as commonly understood as set forth in Annex B of our Funds Letter, in addition to whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act. In order for an entity to be a covered fund, the Agencies should require it to both be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act and have all of the characteristics of a hedge fund or private equity fund set forth in Annex B of our Funds Letter. For the reasons stated in Section IV (C-12) of our Funds Letter, we believe that a definition focusing on an entity's characteristics, in addition to the condition based on section 3(c)(1) or 3(c)(7) of the Investment Company Act, is consistent with the language and purposes of the Volcker Rule statute.

- **Question 222. Instead of adopting a unified definition of "covered fund" for those entities included under section 13(h)(2) of the BHC Act, should the Agencies consider**

having separate definitions for "hedge fund" and "private equity fund"? If so, which definitions and why?

Yes, for the reasons stated in Section IV (C-12) of our Funds Letter, the Agencies should have separate definitions of "hedge fund" and "private equity fund." Erasing the distinction between these two very different types of funds is inconsistent with the language and legislative history of the Volcker Rule and exceeds the statutory authority of the Agencies. Please also see our response to Question 217.

- **Question 223. Should the Agencies consider using the authority provided under section 13(d)(1)(J) of the BHC Act to exempt the acquisition or retention of an ownership interest in a covered fund with certain attributes or characteristics, including, for example: (i) a performance fee or allocation to an investment manager's equity account calculated by taking into account income and realized and unrealized gains; (ii) borrowing an amount in excess of one-half of its total capital commitments or has gross notional exposure in excess of twice its total capital commitments; (iii) sells securities or other assets short; (iv) has restricted or limited investor redemption rights; (v) invests in public and non-public companies through privately negotiated transactions resulting in private ownership of the business; (vi) acquires the unregistered equity or equity-like securities of such companies that are illiquid as there is no public market and third party valuations are not readily available; (vii) requires holding those investments long-term; (viii) has a limited duration of ten years or less; or (ix) returns on such investments are realized and the proceeds of the investments are distributed to investors before the anticipated expiration of the fund's duration? Which, if any, of these characteristics are appropriate to describe a hedge fund or private equity fund that should be considered a covered fund for purposes of this rule? Are there any other characteristics that would be more appropriate to describe a covered fund? If so, which characteristics and why?**

For the reasons stated in Section IV (C-12) of our Funds Letter, we believe that the Agencies have a duty and the authority to exclude certain entities from the definition of "covered fund." We believe that the Agencies should use this authority to exclude the entities described in our answer to Question 217. We believe that Section (d)(1)(J) of the Volcker Rule statute is designed for exempting banking entities from the general prohibitions on investments and relationships with entities that cannot be excluded from the term "covered fund," such as entities that would both be investment companies but for section 3(c)(1) or 3(c)(7) under the Investment Company Act and have all of the characteristics of a hedge fund or private equity fund as commonly understood as set forth in Annex B of our Funds Letter.

But if the Agencies do not exclude all of the entities described in our answer to Question 217 from the term "covered fund," we believe that the Agencies should exercise their authority under Section (d)(1)(J) of the Volcker Rule to exempt banking entities from the general prohibitions on making investments in, acting as sponsor to or entering into covered transactions with such entities for the reasons provided in Section IV.C (C-40) of our Funds Letter. In particular, the Agencies should expand certain of their proposed "permitted activities" exemptions as follows:

1. Super 23A. The Agencies should expand their proposed "permitted activities" exemptions for wholly owned subsidiaries, joint ventures and acquisition vehicles to include all covered transactions otherwise prohibited by Super 23A.

2. Excluded Entities. The Agencies should expand the range of entities to which these "permitted activities" exemptions apply to cover all Excluded Entities (as defined above in our response to Question 217) and exchange traded funds (ETFs).

- **Question 224. Is specific inclusion of certain non-U.S. entities as a "covered fund" under § __.10(b)(1)(iii) of the proposed rule necessary, or would such entities already be considered to be a "covered fund" under § .10(b)(1)(i) of the proposed rule? If so, why? Does the proposed rule's language on non-U.S. entities correctly describe those non-U.S. entities, if any, that should be included in the definition of "covered fund"? Why or why not? What alternative language would be more effective? Should we define non-U.S. funds by reference to the following structural characteristics: whether they are limited in the number or type of investors; whether they operate without regard to statutory or regulatory requirements relating to the types of instruments in which they may invest or the degree of leverage they may incur? Why or why not?**

For the reasons provided in Section IV.B.(2) (C-35) of our Funds Letter, we believe that the Agencies have exceeded their statutory authority to the extent they have designated any foreign fund as a similar fund if it is not actually similar to a hedge fund or private equity fund as properly defined by the proposed rules. In order to bring the proposed rules into compliance with the Agencies' statutory authority, we recommend the following changes:

1. Similar Foreign Funds. The term "similar foreign fund" should be defined as any foreign fund that satisfies *all* of the following conditions:

i. (A) it is engaged primarily in investing, reinvesting or trading in securities *or* (B) it is engaged in investing, reinvesting, owning, holding or trading in securities and the value of its investment securities exceeds 40% of the value of its total consolidated assets; *and*

ii. (A) it does not make a public offering of its securities or (B) it is not eligible to make a public offering and is not subject to regulation of its activities or investments; *and*

iii. its securities are beneficially owned by no more than 100 persons or exclusively by qualified purchasers (as defined in the 1940 Act); *and*

iv. it has all of the characteristics of a hedge fund or private equity fund as commonly understood, as set forth on Annex B of our Funds Letter; *and*

v. it is not an Excluded Entity (as defined above in our response to Question 217) or an exchange traded fund (ETF).

- **Question 225. Are there any entities that are captured by the proposed rule's definition of "covered fund," the inclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?**

Yes, the inclusion of a number of entities within the proposed rule's definition of "covered fund" does not appear to be consistent with the language and purpose of the statute. Please see our response to Question 217 for a description of the entities that should not be included and a list of entities that should be expressly excluded to bring the proposed regulatory definition into line with the language and purpose of the statute.

- **Question 226. Are there any entities that are not captured by the proposed rule's definition of "covered fund," the exclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?**

No, the proposed regulatory definition of "covered funds" is overbroad, not underinclusive.

- **Question 229. Are there entities that issue asset-backed securities (as defined in Section 3(a) of the Exchange Act) that should be exempted from the requirements of the proposed rule? How would such an exemption promote and protect the safety and soundness of the banking entity and the financial stability of the United States as required by section 13(d)(1)(J) of the BHC Act?**

Our Funds Letter limits its discussion of securitization-related issues to credit funds. As discussed in that letter, credit funds should be exempted from the requirements of the proposed rule. In particular, for the reasons provided in Section VI.C. (C-83) of our Funds Letter, we recommend the following:

1. Credit Funds.

    i. Specific Exemption. The Agencies should provide a specific "permitted activities" exemption for sponsoring or investing in, and entering into covered transactions with, related credit funds.

    ii. Part of Asset-Backed Securities Exemption. Alternatively, the Agencies should confirm that (A) the "permitted activities" exemption for sponsoring or investing in issuers of asset-backed securities includes credit funds, (B) the term "asset-backed security" includes "ownership interests" in credit funds, (C) the term "loan" includes all extensions of credit, including notes and bonds, and (D) the exemption extends to covered transactions otherwise prohibited by Super 23A.

- **Question 233. Should entities that rely on a separate exclusion from the definition of investment company other than sections 3(c)(1) or 3(c)(7) of the Investment Company Act be included in the definition of "covered fund"? Why or why not?**

No, based on the plain language of the Volcker Rule statute, such entities are excluded from the statutory definition of the terms "hedge fund" or "private equity fund." Accordingly, the Agencies have no authority to sweep any such entities into the proposed regulatory definition of the term "covered fund" unless they determine by formal rulemaking (*i.e*., subject to prior public notice and comment) that a particular subset of such entities is sufficiently similar to a hedge fund or private equity fund.

- **Question 234. Do the proposed rule's definitions of "ownership interest" and "carried interest" effectively implement the statute? What alternative definitions might be more appropriate in light of the language and purpose of the statute? Are there other types of instruments that should be included or excluded from the definition of "ownership interest"? Does the proposed definition of ownership interest capture most interests that are typically viewed as ownership interests? Is the proposed rule's exemption of carried interest from the definition of ownership interest with respect to a covered fund appropriate? Does the exemption adequately address existing compensation arrangements and the way in which a banking entity becomes entitled to carried interest? Is it consistent with the current tax treatment of these arrangements?**

We believe that the proposed rule's definition of "ownership interest" and exemption of carried interest from the definition of ownership interest is effective and appropriate, except that, for the reasons provided in Section VI.B.(4) (C-75) of our Funds Letter, we recommend the following change in the definition of "carried interest":

1. Carried Interest. The Agencies should clarify that a minimal capital contribution by a banking entity (including any affiliate or employee) to a covered fund for the sole purpose of facilitating certain tax treatment of the banking entity's (including any affiliate's or employee's) carried interest will not affect the exclusion of such carried interest from the definition of "ownership interest."

Please also see our response to Question 239 regarding the exclusion of debt interests from the definition of "ownership interest."

- **Question 237. For purposes of limiting either an exclusion for issuers of asset-backed securities from the proposed definition of "covered fund" and/or an exclusion of asset-backed securities from the proposed definition of "ownership interest," what definition of asset-backed security most effectively implements the language of section 13 of the BHC Act? Section 3(a)(77) of the Exchange Act and the SEC's Regulation AB[1] provide two possible definitions. Is either of these definitions sufficient, and if so why? If one of the definitions is too narrow, what additional entities/securities should be included and why? If one of the definitions is too broad, what entities/securities should be excluded and why? Would some other definition of asset-backed security be more consistent with the language and purpose of section 13 of the BHC Act?**

Our Funds Letter limits its discussion of securitization-related issues to credit funds. Please see our response to Question 229 regarding credit funds.

[1] *See* 17 C.F.R. § 229.1101(c).

- Question 239. **Should the legal form of a beneficial interest be a determining factor for deciding whether a beneficial interest is an "ownership interest"? For example, should pass- through trust certificates issued as part of a securitization transaction be excluded from the definition of "ownership interest"? Should the definition of ownership interest explicitly include debt instruments with equity features (e.g., voting rights, profit participations, etc.)?**

The definition of ownership interest should not explicitly include debt instruments with equity features unless the equity features are so pervasive that the debt instrument is the functional equivalent of an "equity interest" or "partnership interest" and the Agencies have determined that the debt instrument was structured to evade the requirements of the Volcker Rule. The statutory text of the Volcker Rule generally prohibits any acquisition by a banking entity of an "equity, partnership, or other ownership interest"[2] in a hedge fund or private equity fund. It does not define the term "ownership interest." In the supplementary information accompanying the proposed rule text (but not the proposed rule text itself), the Agencies note that, where a debt security or other interest of a covered fund "exhibits substantially the same characteristics as an equity or other ownership interest," the Agencies "could" consider such instrument an "ownership interest."[3]

Under the *noscitur a sociis* canon of statutory construction, however, "when two or more words are grouped together, and ordinarily have a similar meaning, but are not equally comprehensive, the general word will be limited and qualified by the special word."[4] Here, the general word is "ownership interest" and the "special words" are "equity . . . interest" and "partnership . . . interest." An equity or partnership interest does not include a debt interest. Therefore, it exceeds the Agencies' authority to define the general term "or other ownership interest," which must be interpreted in light of the specific terms "equity . . . interest" and "partnership . . . interest," to include debt interests unless the equity features are so pervasive that the debt interest is the functional equivalent of an equity interest or partnership interest. We agree that the Agencies have the authority under the anti-evasion provisions of the statute to order, after due notice and opportunity for hearing, that a banking entity terminate an activity or dispose of an investment where the Agencies have reasonable cause to believe that the banking entity has made an investment or engaged in an activity that functions as an evasion of the Volcker Rule's requirements.[5] We therefore recommend that the Agencies retain the proposed definition of "ownership interest" in the final rules and clarify in the supplementary information accompanying the final rules that a debt interest will only be considered an "ownership interest" where the Agencies have determined, after appropriate

[2] *See* 12 U.S.C. § 1851(a)(1)(B).

[3] *See* 76 Fed. Reg. at 68897.

[4] SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 47:16, at 348-51 (7th ed. 2007) (Norman J. Singer, ed.). *See, e.g.*, *Logan v. United States*, 552 U.S. 23, 30-32 (2007) (applying canon to qualify meaning of general words by reference to nearby specific words); *Washington State Dep't of Social and Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 382-85 (2003) (same); *FTC v. Ken Roberts Co.*, 276 F.3d 583, 589-90 (D.C. Cir. 2001) (same).

[5] *See* 12 U.S.C. § 1851(e)(2).

notice and opportunity for hearing, that the debt interest is the functional equivalent of an equity interest or partnership interest and was structured to evade the restrictions of the Volcker Rule.

- **Question 240. How should the proposed rule address those instances in which both debt and equity interests are issued, and the debt interests receive all of the economic benefits and all of the control rights? Should the debt interests (other than the residual interest) be counted as ownership interests even though they are not legally ownership and do not receive any profit participation? Should the equity interests be counted as ownership interests even though the holder does not receive economic benefits or have any control rights? Should the residual interest be considered the only "ownership interest" for purposes of the proposed rule? Should mezzanine interests that lack both control rights and profit participation be considered an ownership interest? If the mezzanine interests obtain control rights (because more senior classes have been repaid), should they become "ownership interests" at that time for purposes of the proposed rule? If both debt and equity interests are counted as ownership interests, how should percentages of ownership interests be calculated when the units of measurement do not match (e.g., a single trust certificate, a single residual certificate with no face value and multiple classes of currency-denominated notes)?**

  Please see our response to Question 239.

- **Question 241. Does the proposed rule's definition of "prime brokerage transaction" effectively implement the statute? What other types of transactions or services, if any, should be included in the definition? Should any types of transactions or services be excluded from the definition? Would an alternative definition be more effective, and if so, why?**

No, the proposed rule's definition of "prime brokerage transaction" is not entirely effective in implementing the statute. The proposed definition is deficient because it both (i) includes examples of transactions that are not "covered transactions," which a banking entity does not require separate authority to engage in (e.g., "data, operational, and portfolio management support") and (ii) does not clearly exempt "covered transactions" that take the form of the examples provided. We believe that the proposed definition should be amended as follows:

Prime brokerage transaction means a covered transaction ~~one or more products or services provided by~~ entered into by a covered banking entity ~~to~~ with a covered fund, ~~such as~~ including through use of derivatives, for purposes of custody, clearance, securities borrowing or lending services, trade execution and settlement, ~~or~~ financing and related hedging, intermediation, or a similar purpose ~~data, operational, and portfolio management support.~~

- **Question 242. Do the proposed rule's definitions of "sponsor" and "trustee" effectively implement the statute? Is the exclusion of "directed trustee" from the definition of "trustee" appropriate?**

Although the proposed rule's definitions of "sponsor" and "trustee" in large part effectively implement the statute, for the reasons provided in Sections VI.B.(1) (C-61) and VI.B.(1)(b) (C-62) of our Funds Letter, we recommend the following changes:

1. Sponsor. A banking entity should not be treated as the "sponsor" of a covered fund based on selecting a majority of the initial directors, trustees or management of the fund, including any general partner, managing member or board of managing members, if a majority of the persons or entities selected are independent of the banking entity.

2. Limited Trustee. The Agencies should clarify that a "trustee" would not be deemed to be exercising investment discretion solely by virtue of exercising discretion as to the securities lending or collateral or cash management activities of a covered fund.

2. Section _.11: Permitted organizing and offering of a covered fund

a. Required criteria for permitted organizing and offering of covered funds

- **Question 244. Is the proposed rule's approach to implementing the exemption for organizing and offering a covered fund effective? If not, what alternative approach would be more effective and why?**

The proposed rule's approach to implementing the exemption for organizing and offering a covered fund is partially, but not entirely, effective. For the reasons provided in Sections VI.B. (C-60) and VII. (C-106) of our Funds Letter, we recommend the following changes:

1. Attribution Rules.

    i. Controlled Investments. The attribution rule for controlled investments should be limited to controlled entities that fall within the term "banking entity," as properly construed.[6]

    ii. Non-Controlled Investments. The *pro rata* attribution rule for non-controlled investments should be dropped.

    iii. Parallel Co-Investments. The attribution rule for parallel co-investments should be limited to a pattern of multiple co-investments that evidences an intent to evade the investment limits in the asset management exemption.

2. Employee and Director Investments. Investments permissibly made by a director or employee directly engaged in providing investment advisory or other services to a covered fund organized and offered or sponsored under the asset management exemption should not become impermissible solely because the director or employee ceases to provide such services, absent evidence of an intent to evade the prohibitions of the Volcker Rule.

[6] By "as properly construed," we mean as construed in accordance with our recommendations regarding appropriate exclusions from the definition of "banking entity" in Section V. of our Funds Letter.

3. Carried Interest. The Agencies should clarify that a minimal capital contribution by a banking entity (including any affiliate or employee) to a covered fund for the sole purpose of facilitating certain tax treatment of the banking entity's (including any affiliate's or employee's) carried interest will not affect the exclusion of such carried interest from the definition of "ownership interest."

4. Deduction from Regulatory Capital. The deduction from regulatory capital of investments made in covered funds held under the asset management exemption should be eliminated.

5. Seeding Period Extensions.

   i. Both Investment Limits. Extensions of the seeding period should be available for both the per fund and aggregate investment limits.

   ii. Track Records. A procedure should be established to provide banking entities with extensions for the full three years in advance for the limited purpose of establishing a track record for new funds, if certain rigorous conditions are satisfied.

   iii. Cure Period. The Agencies should amend the Proposed Rules to provide banking entities with a six month cure period for any failure to comply with any of the investment limits for reasons beyond their reasonable control.

6. Super 23A. The phrase "covered transaction, as defined in section 23A of the Federal Reserve Act" should be construed to mean the list of prohibited transactions contained in Section 23A(a)(7) of that Act, as qualified by the list of excluded transactions contained in Section 23A(d) of that Act, including the exclusion for intraday extensions of credit contained in the Board's Regulation W.

- **Question 245. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?**

  Please see our answer to Question 244.

- **Question 246. Is the proposed rule's approach to implementing the scope of bona fide trust, fiduciary, investment advisory and commodity trading advisory services consistent with the statute? If not, what alternative approach would be more effective? Should the scope of such services be broader or, in the alternative, more limited? Are there specific services which should be included but which are not currently under the proposed rule?**

We believe that the proposed rule's approach to implementing this condition of the asset management exemption is consistent with the statute, except that, for the reasons provided in Section VI.B.(1)(c) (C-64) of our Funds Letter, we recommend the following change:

1. Commodity Pool Operators. The Agencies should correct a technical oversight in the proposed text of the bona fide trust, fiduciary, investment advisory and commodity trading advisory services condition of the asset management exemption to clarify that a banking entity can satisfy that condition by acting as a commodity pool operator to a covered fund.

- **Question 247. Does the proposed rule effectively implement the "customers of such services" requirement? If not, what alternative approach would be more effective and why? Is the proposed rule's approach consistent with the statute? Why or why not? How do banking entities currently sell or provide interests in covered funds? Do banking entities rely on a concept of "customer" by reference to other laws or regulations, and if so, what laws or regulations?**

Yes, we believe that the proposed rule's approach to implementing the "customers of such services" condition of the asset management exemption is consistent with the language and purpose of the asset management exemption. In particular, we agree with the Agencies that the plain language of the statutory customer requirement permits a banking entity to offer and sell interests in a covered fund to both new and existing customers, and that the statutory customer requirement was not intended to ossify the normal asset management business by limiting the exemption to existing customers only.

Section 13(d)(1)(G)(ii) of the Volcker Rule conditions the availability of the asset management exemption on a banking entity organizing and offering a covered fund "only in connection with" the provision of certain *bona fide* services to "persons that are customers of such services of the banking entity."[7] The Agencies correctly point out that the statute "does not explicitly require that the customer relationship be pre-existing."[8] Indeed, the Agencies note, "[h]istorically, banking entities have raised capital commitments for covered funds from existing customers as well as individuals or entities that have no pre-existing relationship with the banking entity."[9] We agree with the Agencies' interpretation of the statute and their account of the traditional operation of banking entities' asset management businesses with respect to raising capital from customers.

Although the conditions of the asset management exemption, such as the "customer" condition, were designed to place certain limits on the ability of a banking entity to organize, offer and sponsor hedge funds and private equity funds, they were not designed to disrupt a banking entity's ability to provide asset management services to customers. Instead, they were designed to preserve the ability of the banking entity to organize, offer and sponsor such funds as part of its provision of asset management services, subject to the safety and soundness protections in the exemption. As a result, these conditions should be interpreted to permit, not constrain, traditional asset management practices with respect to hedge funds and private equity funds, subject only to the safety and soundness protections contained in the asset management exemption itself or in other parts of the Volcker Rule.

[7] *See* 12 U.S.C. § 1851(d)(1)(G)(ii).

[8] *See* 76 Fed. Reg. at 68901.

[9] *Id*.

Banking entities have traditionally offered interests in hedge funds and private equity funds as part of the provision of asset management services both to existing customers and to persons who have not previously invested in any of these funds or otherwise established a formal trust, fiduciary or investment advisory relationship with the banking entity. Indeed, a significant portion of investors in these funds have been new customers. But in order for the sale of investments to these new customers to qualify for a private placement exemption from the securities registration requirements of the Securities Act of 1933 (the "Securities Act") under Regulation D thereunder, the banking entities or their affiliates or agents have been required to establish a "substantive pre-existing relationship" ("SPR") with the new customers before accepting them as investors in the funds.

As the Agencies note in the supplementary information, "[t]he proposed rule does not change any requirement imposed by separate statute, regulation or other law."[10] We believe that the SPR requirement, which therefore remains in effect, strikes an appropriate balance between requiring an established customer relationship and not entirely freezing all customer relationships at a particular point in time or otherwise requiring that a separate customer relationship be established in situations where the investor is interested in the services of a banking entity only in connection with a specific hedge fund or private equity fund. It is familiar to personnel at banking entities who provide asset management services because they have long had to comply with it in order to obtain a private placement exemption for the offer and sale of ownership interests in the hedge funds or private equity funds they have organized and offered. Indeed, they already have policies and procedures in place to ensure that an SPR will exist prior to offering any hedge fund or private equity fund to a prospective investor. The SEC has provided guidelines on how an SPR can be established with a new customer. In the case of new customers, the SEC requires a minimum of at least thirty days to establish an SPR, but in practice the process generally takes several months to satisfy. As a result, we believe that the SPR requirement imposes the sort of limitations contemplated by the customer condition in Section (d)(1)(G)(ii), while preserving traditional flexibility to establish new customer relationships if certain additional conditions are satisfied.

- **Question 248. Does the proposed rule effectively and clearly recognize the manner in which banking entities provide trust, fiduciary, investment advisory, or commodity trading advisory services to customers? If not, how should the proposed rule be modified to be more effective or clearer?**

Yes, the proposed rule generally effectively and clearly recognizes the manner in which banking entities provide trust, fiduciary, investment advisory, or commodity trading advisory services to customers. Please also see our response to Question 247.

- **Question 249. Should the Agencies consider adopting a definition of "customer of such services" for purposes of implementing the exemption related to organizing and offering a covered fund? If so, what criteria should be included in such definition? For example, should the customer requirement specify that the relationship be pre-existing? Should the Agencies consider adopting an existing definition related to**

[10] *Id.*

"customer" and if so, what definitions (for instance, the SEC's "pre-existing, substantive relationship" concept applicable to private offerings under its Regulation D) would provide for effective implementation of the customer requirement in section 13(d)(1)(G) of the BHC Act? If so, why and how? How should the customer requirement be applied in the context of non-U.S. covered funds? Is there an equivalent concept used for such non-U.S. covered fund offerings?

Please see our response to Question 247.

▪ **Question 250. Should the Agencies distinguish between direct and indirect customer relationships for purposes of implementing section 13(d)(1)(G) of the BHC Act? Should the rule differentiate between a customer relationship established by a customer as opposed to a banking entity? If so, why?**

Please see our response to Question 247.

▪ **Question 251. Does the proposed rule effectively implement the prohibition on a banking entity guaranteeing or insuring the obligations or performance of certain covered funds? If not, what alternative approach would be more effective, and why?**

Yes, we believe the proposed rule effectively implements the prohibition on guaranteeing or insuring the obligations or performance of covered funds organized and offered under Section 13(d)(1)(G) of the Volcker Rule.

▪ **Question 252. Does the proposed rule effectively implement the requirement that a banking entity comply with the limitation on certain relationships with a covered fund contained in § __.16 of the proposed rule? If not, what alternative approach would be more effective, and why?**

With respect to a covered fund that is organized and offered under the asset management exemption, we believe that the proposed rule is consistent with the requirement that a banking entity comply with Super 23A, except that, for the reasons provided in Sections VII.A. (C-106) of our Funds Letter, we recommend the following change:

1. Covered Transactions. The phrase "covered transaction, as defined in section 23A of the Federal Reserve Act" should be construed to mean the list of prohibited transactions contained in Section 23A(a)(7) of that Act, as qualified by the list of excluded transactions contained in Section 23A(d) of that Act, including the exclusion for intraday extensions of credit contained in the Board's Regulation W.

▪ **Question 253. Does the proposed rule effectively implement the prohibition on a covered fund sharing the same name or variation of the same name with a banking entity? If not, what alternative approach would be more effective and why? Should the prohibition on a covered fund sharing the same name be limited to specific types of banking entities (e.g., insured depository institutions and bank holding companies) or only to the banking entity that organizes and offers the fund, and if so why?**

Yes, the proposed rule effectively and appropriately implements the prohibition on a covered fund sharing the same name or variation of the same name with a banking entity, except that, for the reasons provided in Section V.B.(8) (C-55) of our Funds Letter, we recommend the following change:

1. Investment Management Affiliates. Solely for purposes of the name sharing condition in the asset management exemption, all investment management affiliates should be excluded from the definition of "banking entity," provided that such investment management affiliates do not share a name with an insured depository institution affiliate or the ultimate parent of such an insured depository institution affiliate.

▪ **Question 254. Does the proposed rule effectively implement the limitation on director or employee investments in a covered fund organized and offered by a banking entity? If not, what alternative approach would be more effective and why? Should the agencies provide additional guidance on what "other services" should be included for purposes of satisfying § __.11(g)? Why or why not?**

Yes, the proposed rule effectively and appropriately addresses the limitation on director or employee investments in a covered fund organized and offered under the asset management exemption, including the circumstances under which an investment by a director or employee of a banking entity in a covered fund would be attributed to a banking entity, except that, for the reasons provided in Section VI.B.(3) (C-74) of our Funds Letter, we recommend the following change:

1. Employee and Director Investments. Investments permissibly made by a director or employee directly engaged in providing investment advisory or other services to a covered fund organized and offered or sponsored under the asset management exemption should not become impermissible (and therefore attributed to the banking entity) solely because the director or employee ceases to provide such services, absent evidence of an intent to evade the prohibitions of the Volcker Rule.

3. Section __.12: Permitted investment in a covered fund

f. Extension of time to divest an ownership interest in a single covered fund

▪ **Question 256. Is the proposed rule's approach to implementing the exemption that allows a banking entity to make or retain a permitted investment in a covered fund effective? If not, what alternative approach would be more effective and why?**

The proposed rule's approach to implementing Section (d)(4) of the statute is effective and consistent with the plain language and legislative history of the statute to the extent the proposed rule construes the ownership limits in Section (d)(4) of the statute as applying only to investments permitted under the asset management exemption. The ownership limits in Section (d)(4) of the statute do not apply to investments made under any of the other "permitted activities" exemptions. To construe Section (d)(4) otherwise would be inconsistent with the plain language and legislative history of the Volcker Rule. The proposed rule's approach to implementing Section (d)(4) properly reflects this interpretation.

We also believe that the proposed rule's approach to implementing Section (d)(4) of the statute in the context of the asset management exemption is effective, except that we believe the proposed attribution rules should be modified as described in our response to Question 244.

- **Question 258. Should the proposed rule specify at what point a covered fund will be considered to have been "established" for purposes of commencing the period in which a banking entity may own more than 3 percent of the total outstanding ownership interests in such fund? If so, why and how?**

Yes, the proposed rule should specify that a covered fund will be considered to have been "established" for purposes of commencing the period in which a banking entity may own more than 3 percent of the total outstanding ownership interests in such fund as of the date that the covered fund makes its first investment.

For purposes of determining whether a covered fund was "established" prior to any other relevant date in the Volcker Rule (e.g., July 21, 2012 or May 1, 2010), the relevant date should be the date on which third-party investors were first admitted to the fund or acquired interests in such fund. This distinction recognizes that a banking entity may have expended considerable time and effort attracting outside investors for a new covered fund prior to those dates, and should not be prevented from benefitting from the general conformance period or extended conformance period for illiquid funds, as appropriate, simply because they had not completed the capital raising process and begun investment activities by such dates.

- **Question 259. Does the proposed rule effectively implement the requirement that a banking entity comply with the limitations on an investment in a single covered fund? If not, what alternative approach would be more effective and why?**

Yes, the proposed rule effectively implements the requirement that a banking entity comply with the limitations on an investment in a single covered fund, except that we believe the proposed attribution rules should be modified as described in our response to Question 244.

- **Question 260. Does the proposed rule effectively implement the requirement that a banking entity comply with the limitations on the aggregate of all investments in all covered funds? If not, what alternative approach would be more effective and why?**

Yes, the proposed rule effectively implements the requirement that a banking entity comply with the limitations on the aggregate of all investments in all covered funds, except that we believe the proposed attribution rules should be modified as described in our response to Question 244.

In addition, we believe that the Agencies should clarify that the 3% Tier 1 *de minimis* investment limit will be calculated based on the acquisition cost, rather than the "value," of a banking entity's ownership interests in covered funds held pursuant to the asset management exemption. To do otherwise would have the perverse effect of penalizing a banking entity by reducing the headroom available under the 3% Tier 1 *de minimis* cap for additional investments when a banking entity's investments perform well, and increasing that headroom when a banking entity's investments do not perform well.

This flawed approach is outside the scope of the statute. The statute makes no mention of the term "value." Instead, the statute limits the "size of investments" and the banking entity's "interests."[11] Adding a "value" limitation is outside of the Agencies' statutory authority and therefore invalid.[12]

- **Question 261. Is the proposed rule's approach to calculating a banking entity's investment in a covered fund effective? Should the per-fund calculation be based on committed capital, rather than invested capital? Why or why not? Is the timing of the calculation of a banking entity's ownership interest in a single covered fund appropriate? If not, why not, and what alternative approach would be more effective and why? For example, should the per-fund calculation be required on a less-frequent basis (e.g., monthly) for funds that compute their value and allow purchases and redemptions on a daily basis (e.g., liquidity funds daily)? Why or why not?**

The proposed rule's approach to calculating a banking entity's investment in a covered fund is effective to the extent that the Agencies provided in § __.12(b)(2)(A) that compliance with the *de minimis* investment limits would be tested with reference to invested capital, not committed capital. The Volcker Rule does not prohibit commitments to invest in hedge funds or private equity funds. It prohibits only the actual acquisition or retention of ownership interests in them. Until an investment is made, committed capital represents merely the potential for the acquisition of an ownership interest. In fact, it is not unusual for a fund to call less than the full amount of an investor's committed capital. We also note that any capital returned to a banking entity or other investor, for example upon the sale or other disposition of a portfolio company or other investment, should reduce total invested capital for purposes of calculating the *de minimis* investment limits.

- **Question 262. Is the proposed rule's approach to parallel investments effective? Why or why not? Should this provision require a contractual obligation and/or knowing participation? Why or why not? How else could the proposed rule define parallel investments? What characteristics would more closely achieve the scope and intended purposes of section 13 of the BHC Act?**

No, the proposed rule's approach to parallel investments is not effective. Please see our response to Question 244.

- **Question 263. Is the proposed rule's treatment of investments in a covered fund by employees and directors of a banking entity effective? If not, what alternative approach would be more effective and why?**

Yes, the proposed rule's treatment of investments in a covered fund by employees and directors of a banking entity is effective, but see certain modifications we recommend in our response to Question 254.

[11] *See* 12 U.S.C. § 1851(d)(4)(B)(ii).

[12] *See Am. Library Ass'n,* 406 F.3d at 699–700.

- **Question 264. Is the proposed rule's approach to differentiating between controlled and non-controlled investments in a covered fund unduly complex or burdensome? If so, what alternative approach, if any, would be more effective and why?**

Yes, the proposed rule's approach to differentiating between controlled and non-controlled investments in a covered fund is unduly burdensome. Please see our response to Question 244.

- **Question 268. Should the proposed rule be modified to permit a banking entity to bring its investments in covered funds into compliance with the proposed rule within a reasonable period or of time if, for example, the banking entity's aggregate permitted investments in covered funds exceeds 3 percent of its tier 1 capital for reasons unrelated to additional investments (e.g., a banking entity's tier 1 capital decreases)? Why or why not?**

Yes, the proposed rule should be modified to permit a banking entity to bring its investments in covered funds into compliance with the proposed rule within six months of any failure to comply with any of the investment limits for reasons beyond the banking entity's reasonable control, as recommended in Section VI.B.(7) (C-82) of our Funds Letter.

- **Question 269. Does the proposed rule effectively and appropriately implement the deduction from capital for an investment in a covered fund contained in section 13(d)(4)(B)(iii) of the BHC Act? If not, what alternative approach would be more effective or appropriate, given the statutory language of the BHC Act and overall structure of section 13(d)(4), and why? What effect, if any, should the agencies give to the cross-reference in section 13(d)(4) to section 13(d)(3) of the BHC Act, which provides agencies with discretion to require additional capital, if appropriate, to protect the safety and soundness of banking entities engaged in activities permitted under section 13 of the BHC Act? How, if at all, should a banking entity's deduction of its investment in a covered fund be increased commensurate with the leverage of the covered fund? Should the amount of the deduction be proportionate to the leverage of the covered fund? For example, instead of a dollar-for-dollar deduction, should the deduction be set equal to the banking entity's investment in the covered fund times the difference between 1 and the covered fund's equity-to-assets ratio?**

No, the proposed rule does not effectively and appropriately implement the deduction from capital for an investment in a covered fund contained in section 13(d)(4)(B)(iii) of the BHC Act. For the reasons provided in Section VI.B.(5) (C-76) of our Funds Letter, including the Agencies' lack of authority to impose any capital deduction requirement except for purposes of determining compliance with any additional capital requirements that the Agencies may in the future impose, we recommend that the deduction from regulatory capital of investments made in covered funds held under the asset management exemption be eliminated.

- **Question 270. Does the proposed rule effectively implement the Board's statutory authority to grant an extension of the period of time a banking entity may retain in excess of 3 percent of the ownership interests in a single covered fund? Are the**

enumerated factors that the Board may consider in connection with reviewing such an extension appropriate (including factors related to the effect of an extension of the covered fund), and if not, why not? Are there additional factors that the Board should consider in reviewing such a request? Are there specific additional conditions or limitations that the Board should, by rule, impose in connection with granting such an extension? If so, what conditions or limitations would be more effective?

No, the proposed rule does not effectively implement the Board's statutory authority to grant an extension of the period of time a banking entity may retain in excess of 3 percent of the ownership interests in a single covered fund. Please see our response to Question 347. For the reasons provided in Section VI.B.(6)(b) (C-81) and VI.B.(7) (C-82) of our Funds Letter, we recommend the following changes:

1. Track Records. A procedure should be established to provide banking entities with extensions for the full three years in advance for the limited purpose of establishing a track record for new funds, if certain rigorous conditions are satisfied.

2. Cure Period. The Agencies should amend the Proposed Rules to provide banking entities with a six month cure period for any failure to comply with any of the investment limits for reasons beyond their reasonable control.

- **Question 271. Given that the statute does not provide for an extension of time for a banking entity to comply with the aggregate funds limitation, within what period of time should a banking entity be required to bring its investments into conformance with the aggregate funds limit? Should the proposed rule expressly contain a grace period for complying with these limits? Why or why not? If yes, what grace period would be most effective and why?**

We believe that the Agencies should provide for an extension of time for a banking entity to comply with the aggregate funds limitation, and that the proposed rule should expressly contain a grace period for complying with the aggregate funds limit. For the reasons provided in Sections VI.B.(6)(a) (C-79) and VI.B.(7) (C-82) of our Funds Letter, we recommend the following changes:

1. Both Investment Limits. Extensions of the seeding period should be available for both the per fund and aggregate investment limits.

2. Cure Period. The Agencies should amend the Proposed Rules to provide banking entities with a six month cure period for any failure to comply with any of the investment limits for reasons beyond their reasonable control.

- **Question 272. Does the proposed rule effectively implement the prohibition on a banking entity guaranteeing or insuring the obligations or performance of certain covered funds? If not, what alternative approach would be more effective and why?**

Yes, the proposed rule effectively implements the prohibition on a banking entity guaranteeing or insuring the obligations or performance of certain covered funds.

4. Section __.13: Other permitted covered fund activities and investments

a. Permitted investments in SBICs and related funds

- **Question 276. Is the proposed rule's approach to implementing the SBIC, public welfare and qualified rehabilitation investment exemption for acquiring or retaining an ownership interest in a covered fund effective? If not, what alternative approach would be more effective?**

Yes, the proposed rule's approach to implementing the SBIC, public welfare and qualified rehabilitation investment exemption for acquiring or retaining an ownership interest in a covered fund is effective, except that, for the reasons provided in Section VI.F. (C-102) of our Funds Letter, we recommend the following change:

1. SBICs. The Agencies should clarify that an "investment that is designed primarily to promote the public welfare, of the type" permitted under 12 U.S.C. 24 (Eleventh) is not limited to investments in the United States.

b. Permitted risk-mitigating hedging activities

Question 281. Is the proposed rule's approach to implementing the hedging exemption for acquiring or retaining an ownership interest in a covered fund effective? If not, what alternative approach would be more effective?

No, the proposed rule's approach to implementing the hedging exemption for acquiring or retaining an ownership interest in a covered fund is not effective. For the reasons provided in Section VI.E. (C-91) of our Funds Letter, we recommend the following changes:

1. Risk-Mitigating Hedging. The Agencies should provide a single hedging exemption for both the proprietary trading and covered fund portions of the Volcker Rule, eliminating the additional conditions for covered funds.

2. Minimum Alternative. If the agencies do not adopt a single hedging exemption as requested above, the Agencies should, at a minimum:

    i. Profits and Losses Condition. Clarify that the "profits and losses" condition does not prohibit banking entities from hedging exposures to covered fund-linked products designed to facilitate customer exposure to either or both the profits (or a portion of the profits) or the losses (or a portion of the losses) of a covered fund reference asset;

    ii. Same Amount of Ownership Interest Condition. Clarify that, notwithstanding the "same amount of ownership interest" condition, dynamic delta hedging of covered fund-linked products is permitted by the hedging exemption for covered funds and that "portfolio" hedging of exposures to covered fund-linked products is permitted;

iii. Customer Request Condition. Clarify or eliminate the "specific customer request" condition in order to ensure that banking entities may continue innovating and offering covered fund-linked products to existing and new customers in accordance with market practice, customer expectations and applicable laws and regulations;

iv. Non-Banking Entity Condition. Eliminate the prohibition on hedging a customer exposure where the customer is a banking entity or, at a minimum, amend it to permit reliance on certain customer representations;

v. Interaffiliate Transactions. Clarify that interaffiliate transactions will be deemed part of a coordinated activity for purposes of determining compliance with a permitted activity, including risk-mitigating hedging activities; and

vi. Grandfathered Hedging Activities. With respect to covered fund-linked products sold to customers before the effective date of the Volcker Rule, permit banking entities to continue to engage in the types of risk-mitigating hedging activities that they were engaged in before the effective date with respect to such products, so long as they comply with the conditions in the hedging exemption for proprietary trading.

- **Question 282. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?**

No, the approach should not include other elements if by elements the Agencies mean conditions. Instead, many of the conditions should be revised or eliminated as described in our response to Question 281. Please also see our response to Question 256 for an explanation of why the investment limits in Section (d)(4) of the statute are applicable only to investments made under the asset management exemption and why it would be inconsistent with the plain language and legislative history of Section (d)(4) for the Agencies to extend those limits to any of the other "permitted activities" exemptions, including the risk-mitigating hedging exemption.

- **Question 283. What burden will the proposed approach to implementing the hedging exemption have on banking entities? How can any burden be minimized or eliminated in a manner consistent with the language and purpose of the statute?**

  Please see our response to Question 281.

- **Question 284. Are the criteria included in § __.13(b)'s hedging exemption effective? Is the application of each criterion to potential transactions sufficiently clear? Should any of the criteria be changed or eliminated? Should other requirements be added?**

  Please see our response to Question 281.

- **Question 285. Is the requirement that an ownership interest in a covered fund may only be used as a hedge (i) by the banking entity when acting as intermediary on**

behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, or (ii) to cover compensation arrangements with an employee of the banking entity that directly provides investment advisory or other services to that fund effective? If not, what other requirements would be more effective?

Please see our response to Question 281.

- **Question 286. Does the proposed rule sufficiently articulate the types of risks and positions that a banking entity typically would utilize an ownership interest in a covered fund to hedge? If not, how should the proposal be changed?**

  Please see our response to Question 281.

- **Question 287. Is the requirement that that the hedging transaction involve a substantially similar offsetting exposure to the same covered fund and in the same amount of ownership interest to the risk or risks the transaction is intended to hedge or otherwise mitigate effective? If not, how should the requirement be changed? Should some other level of correlation be required? Should the proposal specify in greater detail how correlation should be measured? If not, how could it better do so?**

  Please see our response to Question 281.

- **Question 288. Is the requirement that the transaction not give rise, at the inception of the hedge, to material risks that are not themselves hedged in a contemporaneous transaction effective? Is the proposed materiality qualifier appropriate and sufficiently clear? If not, what alternative would be effective and/or clearer?**

  Please see our response to Question 281.

- **Question 289. Is the requirement that any transaction conducted in reliance on the hedging exemption be subject to continuing review, monitoring and management after the transaction is established effective? If not, what alternative would be more effective?**

  Please see our response to Question 281.

- **Question 290. Is the proposed documentation requirement effective? If not, what alternative would be more effective? What burden would the proposed documentation requirement place on covered banking entities? How might such burden be reduced or eliminated in a manner consistent with the language and purpose of the statute?**

  Please see our response to Question 281.

c. Permitted covered fund activities and investments outside of the United States

__Question 291__. Is the proposed rule's implementation of the "foreign funds" exemption effective? If not, what alternative would be more effective and/or clearer?

No, the proposed rule's implementation of the "foreign funds" exemption is not effective. For the reasons provided in Section VI.G. (C-104) of our Funds Letter, we recommend the following change to the offshore exemption as implemented by the proposed rule:

1. __Offshore Exemption__. A foreign banking organization should be permitted to invest as a limited partner or other similar investor in a covered fund sponsored by an unaffiliated third party as long as such foreign banking organization does not offer or sell ownership interests in the covered fund to U.S. residents and otherwise complies with the statutory conditions of the offshore exemption.

d. Sale and securitization of loans

The Agencies request comment on the proposed rule's approach to implementing the rule of construction related to the sale and securitization of loans. In particular, the Agencies request comment on the following questions:

- **__Question 296__. Is the proposed rule's implementation of the statute's "sale and securitization of loans" rule of construction effective? If not, what alternative would be more effective and/or clearer?**

Our Funds Letter limits its discussion of securitization-related issues to credit funds. Please see our response to Question 229 regarding credit funds.

- **__Question 299__. Are the proposed rule and this Supplementary Information sufficiently clear regarding which derivatives would be allowed in a "securitization of loans" under § .13(d)(3) of the proposed rule? Is additional guidance necessary with respect to the types of derivatives that would be included in or excluded from a securitization of loans for purposes of interpreting the rule of construction contained in section 13(g)(2) of the BHC Act? If so, what topics should the additional guidance discuss and why?**

Our Funds Letter limits its discussion of securitization-related issues to credit funds. Please see our response to Question 229 regarding credit funds.

- **__Question 300__. Should derivatives other than interest rate or foreign exchange derivatives be allowed in a "securitization of loans" for purposes of interpreting the rule of construction contained in section 13(g)(2) of the BHC Act? Why or why not? What would be the legal and economic impact of not allowing the use of derivatives other than interest rate or foreign exchange derivatives in a "securitization of loans" under § __.13(d)(3) of the proposed rule for existing issuers of asset-backed securities and for future issuers of asset-backed securities?**

Our Funds Letter limits its discussion of securitization-related issues to credit funds. Please see our response to Question 229 regarding credit funds.

- **Question 302.1. Should the proposed CFTC Rule include the additional exemptions listed in section 13(d)(1)(J) of the BHC Act in Section __.14 (e.g., BOLI, certain acquisition vehicles)? Please explain the rationale for including or excluding the exemptions in the proposed CFTC Rule.**

Yes, we believe that the CFTC Rule should include the exemptions listed in § __.14 of the Proposed Rules issued by the Board, the SEC, the OCC and the FDIC, consistent with the statutory mandate that the Agencies "assur[e], to the extent possible, that [implementing] regulations are comparable and provide for consistent application and implementation of the applicable provisions of" the Volcker Rule.

5. Section __.14: Covered fund activities and investments determined to be permissible

Question 302. Is the proposed rule's implementation of exemptions for covered fund activities and investments pursuant to section 13(d)(1)(J) of the BHC Act effective? If not, what alternative would be more effective and/or clearer?

For the reasons stated in Section IV (C-12) of our Funds Letter, we believe that the Agencies have a duty and the authority to exclude certain entities from the definition of "covered fund." We believe that the Agencies should use this authority to exclude the entities described in our answer to Question 217. We believe that Section (d)(1)(J) of the Volcker Rule statute is designed for exempting banking entities from the general prohibitions on investments and relationships with entities that cannot be excluded from the term "covered fund," such as entities that would both be investment companies but for section 3(c)(1) or 3(c)(7) under the Investment Company Act and have all of the characteristics of a hedge fund or private equity fund as commonly understood as set forth in Annex B of our Funds Letter.

But if the Agencies do not exclude all of the entities described in our answer to Question 217 from the term "covered fund," we believe that the Agencies should exercise their authority under Section (d)(1)(J) of the Volcker Rule to exempt banking entities from the general prohibitions on making investments in, acting as sponsor to or entering into covered transactions with such entities for the reasons provided in Section IV.C (C-40) of our Funds Letter. In particular, the Agencies should expand certain of their proposed "permitted activities" exemptions as follows:

1. Super 23A. The Agencies should expand their proposed "permitted activities" exemptions for wholly owned subsidiaries, joint ventures and acquisition vehicles to include all covered transactions otherwise prohibited by Super 23A.

2. Excluded Entities. The Agencies should expand the range of entities to which these "permitted activities" exemptions apply to include all Excluded Entities (as defined above in our response to Question 217) and exchange traded funds (ETFs).

Please also see our responses to Question 223 and, with respect to credit funds, Question 229.

- **Question 303. Is the proposed rule's approach to utilizing section 13(d)(1)(J) of the BHC Act to permit a banking entity to acquire or retain an ownership interest in, or act as sponsor to, certain entities that would fall into the definition of covered fund effective? Why or why not? If not, what alternative would be more effective and why? What legal authority under the statute would permit such an alternative?**

  Please see our responses to Questions 217, 223, 302 and, with respect to credit funds, 229.

- **Question 304. Are the proposed rule's provisions regarding when a covered fund activity will be deemed to be permitted under authority of section 13(d)(1)(J) of the BHC Act effective and sufficiently clear? If not, what alternative would be more effective and/or clearer?**

  Please see our responses to Questions 217, 223, 302 and, with respect to credit funds, 229.

- **Question 305. Do the exemptions provided for in § .14 of the proposed rule effectively promote and protect the safety and soundness of banking entities and the financial stability of the United States? If not, why not?**

Yes, as far as they go. Please also see our responses to Questions 217, 223, 302 and, with respect to credit funds, 229.

- **Question 306. Are the proposed rule's provisions regarding what qualifications must be satisfied in order to qualify for an exemption under §__.14 of the proposed rule effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Should additional requirements be added? If so, what requirements and why? Should additional requirements be modified or removed? If so, what requirements and why or how?**

  Please see our responses to Questions 217, 223, 302 and, with respect to credit funds, 229.

- **Question 307. Does the proposed rule effectively cover the scope of covered funds activities which the Agencies should specifically determine to be permissible under section 13(d)(1)(J) of the BHC Act? If not, what activity or activities should be permitted? For additional activities that should be permitted, on what grounds would these activities promote and protect the safety and soundness of banking entities and the financial stability of the United States?**

  Please see our responses to Questions 217, 223, 302 and, with respect to credit funds, 229.

- **Question 308. Does the proposed rule effectively address the interplay between the restrictions on covered fund activities and investments in section 13 of the BHC Act and the requirements imposed on certain banking entities under section 15G of the Exchange Act? Why or why not?**

Please see our responses to Questions 217, 223, 302 and, with respect to credit funds, 229. Please also see our response to Question 256 for an explanation of why the investment limits in Section (d)(4) of the statute are applicable only to investments made under the asset management exemption and why it would be inconsistent with the plain language and legislative history of Section (d)(4) for the Agencies to extend those limits to any of the other "permitted activities" exemptions, including exemptions granted under Section (d)(1)(J) of the statute.

- **Question 309. Rather than permitting the acquisition or retentions of an ownership interest in, or acting as sponsor to, specific covered funds under section 13(d)(1)(J) of the BHC Act, should the Agencies use the authority provided under section 13(d)(1)(J) to permit investments in a covered fund that display certain characteristics? If so, what characteristics should the Agencies consider? How would investments with such characteristics promote and protect the safety and soundness of the banking entity and promote the financial stability of the United States?**

  Please see our response to Question 223.

- **Question 311. Should non-U.S. funds or entities be included in the definition of "covered fund"? Should any non-U.S. funds or entities be excluded from this definition? Why or why not? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the BHC Act?**

  Please see our response to Question 224.

- **Question 312. Should so-called "loan funds" that invest principally in loans and not equity be excluded from the definition of "covered fund"? Why or why not? What characteristics would be most effective in determining whether a fund invests principally in loans and not equity? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the BHC Act?**

  Please see our response to Question 229.

7. Section __.16: Limitations on relationships with a covered fund

Question 314. Is the proposed rule's approach to implementing the limitations on certain transactions with a covered fund effective? If not, what alternative approach would be more effective and why?

No, the proposed rule's approach to implementing Super 23A is not effective. For the reasons stated in Sections IV.C.(1) (C-41), IV.C.(2) (C-43), VI.A. (C-57), VII.A.(1) (C-106), VII.B. (C-112) and IX.C (C-121) of our Funds Letter, we recommend the following changes:

1. Wholly Owned Subsidiaries, Joint Ventures and Acquisition Vehicles. The Agencies should expand their proposed "permitted activities" exemptions for wholly owned

subsidiaries, joint ventures and acquisition vehicles to include all covered transactions otherwise prohibited by Super 23A.

2. Excluded Entities. The Agencies should expand the range of entities to which these "permitted activities" exemptions apply to include all Excluded Entities (as defined in our response to Question 217).

3. Permitted Activities. The Agencies should provide that all of the "permitted activities" exemptions, other than the asset management exemption, will apply to Super 23A.

4. Covered Transactions. The phrase "covered transaction, as defined in section 23A of the Federal Reserve Act" should be construed to mean the list of prohibited transactions contained in Section 23A(a)(7) of that Act, as qualified by the list of excluded transactions contained in Section 23A(d) of that Act, including the exclusion for intraday extensions of credit contained in the Board's Regulation W.

5. Collateral. The Agencies should clarify that the DPC exemption permits a banking entity to take ownership interests in a related fund as collateral to secure extensions of credit to a customer notwithstanding Super 23A.

6. New Covered Transactions. The Board should clarify that a banking entity may, during the conformance period, continue to enter into new covered transactions with a covered fund that was established before the effective date of the statute.

- **Question 315. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?**

  Please see our response to Question 314.

- **Question 316. What types of transactions or relationships that currently exist between banking entities and a covered fund (or another covered fund in which such covered fund makes a controlling investment) would be prohibited under the proposed rule? What would be the effect of the proposed rule on banking entities' ability to continue to meet the needs and demands of their clients? Are there other transactions between a banking entity and such covered funds that are not already covered but that should be prohibited or limited under the proposed rule?**

  Please see our response to Question 314.

- **Question 317. Should the Agencies provide a different definition of "prime brokerage transaction" under the proposed rule? If so, what definition would be appropriate? Are there any transactions that should be included in the definition of "prime brokerage transaction"? Are there transactions or practices provided by banking entities that should be excluded in order to mitigate the burdens of complying with section 13 of the BHC Act?**

Please see our response to Question 241 regarding recommended changes to the definition of "prime brokerage transaction."

- **Question 318. With respect to the CEO (or equivalent officer) certification required under section 13(f)(3)(A)(ii) of the BHC Act and § __.16(a)(2)(ii)(B) of the proposed rule, what would be the most useful, efficient method of certification (e.g., a new stand-alone certification, a certification incorporated into an existing form or filing, website certification, or certification filed directly with the relevant Agency)?**

  We believe that a stand-alone certification would be the most useful, efficient form.

8. Section __.17: Other limitations on permitted covered funds activities

The Agencies request comment on the proposed limitations on permitted covered fund activities and investments, including with respect to the questions in Part III.B.6 of the Supplemental Information as they pertain to covered fund activities and investments in particular.

E. Subpart E – Conformance Provisions

Request for comment. In light of the interplay between the Board's Conformance Rule and the current proposed rule, the Board is requesting comment on whether any of the conformance provisions should be revised. In particular, the Board requests comment on the following question:

- **Question 347. Should any portion of the Board's Conformance Rule be revised in light of other elements of the current proposed rule? If so, why and how?**

  Yes, the Board's Conformance Rule should be revised. For the reasons provided in Section IX.D. (C-121) of our Funds Letter, we recommend the following changes:

1. Illiquid Funds. The Board should amend its conformance rules to provide a meaningful extended conformance period for illiquid funds, which will require changes to the definitions of "illiquid assets," "contractual obligation" and "necessary to fulfill a contractual obligation," and treatment of new illiquid funds and illiquid ownership interests.

Please also see our responses to Questions 1 to 3 regarding whether the proposed effective date provides banking entities with sufficient time to prepare to comply with the prohibitions and restrictions of the Volcker Rule, including its compliance program, reporting and recordkeeping requirements.

E. Additional Request for Comment

- **Question 348. What are the expected costs and benefits of complying with the requirements of the proposed rule? We seek commenters' estimates of the aggregate cost or benefit that would be incurred or received by banking entities subject to section 13 of the BHC Act to comply. We also ask commenters to break out the costs or benefits of compliance to banking entities with each individual aspect of the proposed rule. Please provide an explanation of how cost or benefit estimates were**

derived. Please also identify any costs or benefits that would occur on a one time basis and costs that would recur. Would particular costs or benefits decrease or increase over time? If certain costs or benefits cannot be estimated, please discuss why such costs or benefits cannot be estimated.

For the reasons provided in Section III (C-4) of our Funds Letter, we believe that the Agencies are required to conduct a rigorous cost/benefit analysis of the Proposed Rules as a whole, and rule-by-rule, as required by the *Business Roundtable* decision.

We believe that this cost/benefit analysis is required under a variety of statutes, executive orders and Agency policy statements.[13] For example, we believe that the Agencies must conduct a cost/benefit analysis under the Regulatory Flexibility Act unless the Proposed Rules would not have a significant economic impact on a substantial number of small entities. We do not believe it is enough, under the *Business Roundtable* decision, for the Agencies to provide bare certifications that the Proposed Rules would have no such impact.[14] We believe that the *Business Roundtable* decision requires the Agencies to provide sufficient evidence to support their certifications;[15] otherwise, their certifications will be invalidated as "arbitrary and capricious and not in accordance with law."[16] We do not believe that the Agencies satisfied these mandatory evidentiary requirements.[17] There is nothing in the statutory text of the Volcker Rule that excuses the Agencies from complying with these cost/benefit analysis mandates. They were and remain binding background law against which the Volcker Rule was enacted and against which the Volcker Rule must be interpreted.

If the Agencies perform the sort of cost/benefit analysis required by the *Business Roundtable* decision, we believe they will find that the costs of many provisions of the Proposed Rules will substantially outweigh their benefits. For example, we believe that the enormous compliance, restructuring and other social costs that will result from designating all commodity pools and all foreign funds as similar funds, or from failing to exclude all wholly owned subsidiaries from the term covered fund, will greatly exceed any conceivable public benefits.[18]

In short, unless the Agencies conduct an adequate cost/benefit analysis of the Proposed Rules as a whole, and rule-by-rule, and consider seriously all public comments, we believe that the Proposed Rules will be considered "arbitrary and capricious and not in accordance

[13] *See, e.g.*, Sections 3(f) and 23(a)(2) of the Securities Exchange Act of 1934; the Regulatory Flexibility Act; the Unfunded Mandates Reform Act of 1995; the Small Business Regulatory Enforcement Fairness Act of 1996; and certain executive orders binding on executive agencies.

[14] *See Business Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (The court "must assure [itself] the agency has examined the relevant data and articulated a satisfactory explanation for its action.").

[15] *See id*. at 1150 (rule invalid when agency "relie[s] upon insufficient empirical data.").

[16] *Id.* at 1148.

[17] *See* 76 Fed. Reg. at 68938-39.

[18] *See* our discussion of the designation of commodity pools and foreign funds as similar funds and of wholly owned subsidiaries as covered funds in Sections IV.B.(1), (2) and IV.A.(3)(a) of our Funds Letter.

with law" under the Administrative Procedure Act ("APA"), as construed by the court in *Business Roundtable*.[19] Moreover, they cannot cure this defect without re-proposing the rules for public comment with a proper economic analysis in the NPRs. Failure to provide the public with an opportunity to comment on a required cost/benefit analysis has given rise in the past to litigation that resulted in the vacating of rules. In *Chamber of Commerce v. SEC* (Chamber II), for example, the SEC readopted a rule based on materials that had not been exposed to public comment.[20] The SEC argued that re-proposal was unnecessary because the new materials merely confirmed the agency's initial analysis. The court, finding that additional notice and comment was required, vacated the rule.[21]

As in Chamber II, the Agencies have not provided the sort of cost/benefit analysis required by law. In one instance, they even asked commenters to provide such analysis.[22] But that would not do, because the Agencies' analysis would not be subject to public comment.[23] The opportunity for the public to comment on the analysis underlying an agency's action is a required part of notice and comment rulemaking under the APA.[24] The Agencies must either develop a more robust economic analysis on their own, or through materials provided by commenters. Either method requires a re-proposal.[25]

- **Question 348.1. The CFTC seeks comment on the proposed rule's effects on market-making and liquidity, the costs of borrowing by businesses and consumers, the prices of financial assets, and the competitiveness of the United States financial services sector. The Commission also solicits comment on the benefits that will result from**

[19] *See Business Roundtable*, 647 F.3d at 1148 (D.C. Cir. 2011) (agency's "failure to apprise itself – and hence the public and the Congress – of the economic impact of a proposed regulation makes promulgation of the rule arbitrary and capricious and not in accordance with law") (internal quotation marks omitted).

[20] *See Chamber of Commerce v. SEC* (Chamber II), 443 F.3d 890, 905 (D.C. Cir. 2006) (public was entitled to notice of and an opportunity to comment on materials that were significant to agency's analysis).

[21] *See* Chamber II, 443 F.3d at 903-05.

[22] *See, e.g.*, 76 Fed. Reg. at 68870 (asking for comments on the costs and benefits of proposed market-making definition without providing any indication of the agencies' views); 76 Fed. Reg. at 68926 ("We seek comment on whether, in order to comply with the statutory prohibition on proprietary trading, some banking entities may be inclined to abstain from some market-making activities [and] this could result in reduced liquidity for certain types of trades or for certain less liquid instruments."); *Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation: J. Hearing Before the Subcomms. on Cap. Markets and Gov. Sponsored Enterprises and Fin. Institutions and Consumer Credit of the H. Comm. on Fin. Services*, 112th Cong. (2012) (Chairman Schapiro asserting, in response to a question by Rep. Gutierrez, that the Agencies have "asked for extensive comment in the joint release about the costs of implementation as well as the costs and the impacts on competitiveness of the Volcker Rule.").

[23] *See* Chamber II, 443 F.3d at 899-901.

[24] *See id.*; *Engine Mfrs. Ass'n v. EPA*, 20 F.3d 1177, 1182 (D.C. Cir. 1994) (invalidating rule because published materials were too "opaque" and "[t]here [was] no way to know the agency's methodology from what little it reveal[ed] in the cost analysis"); *Prometheus Radio Project v. FCC*, 652 F.3d 431, 447-53 (3d Cir. 2011) (vacating and remanding an FCC rule because the FCC released "several additional peer review comments, 'revised' versions of four of the studies, and new peer review studies" on the last day for comments).

[25] *See Portland Cement Ass'n v. Ruckelshaus*, 486 F.2d 375, 393 (D.C. Cir. 1973).

the proposed regulations and how these benefits compare to the costs of complying with the proposed regulations. The Commission also solicits comment on the CFTC's assessments of the costs and benefits of the regulations proposed herein.

Please see our response to Question 348.

- **Question 349. Please identify any costs or benefits that would occur on a one-time basis and costs or benefits that would recur (e.g., training and compliance monitoring). Please identify any costs or benefits that you believe would decrease over time. Please identify any costs or benefits that you believe may increase over time or remain static.**

  Please see our response to Question 348.

- **Question 351. Please identify the ways, if any, that banking entities might alter the ways they currently conduct business as a result of the costs that could be incurred to comply with the requirements of the proposed rule. Do you anticipate that banking entities will terminate any services or products currently offered to clients, customers, or counterparties due to the proposed rule, if adopted? Please explain.**

  Please see our response to Question 348.

- **Question 353. Would the proposed rule create any additional implementation or operational costs or benefits associated with systems (including computer hardware and software), surveillance, procedural, recordkeeping, or personnel modifications, beyond those discussed in the above analysis? Would smaller banking entities be disproportionately impacted by any of these additional implementation or operational costs?**

  Please see our response to Question 348.

- **Question 354. We seek specific comments on the costs and benefits associated with systems changes on banking entities with respect to the proposed rule, including the type of systems changes necessary and quantification of costs associated with changing the systems, including both start-up and maintenance costs. We request comments on the types of jobs and staff that would be affected by systems modifications and training with respect to the proposed rule, the number of labor hours that would be required to accomplish these matters, and the compensation rates of these staff members.**

  Please see our response to Question 348.

- **Question 355. Please discuss any human resources costs associated with the proposed rule, along with any associated overhead costs.**

  Please see our response to Question 348.

- **Question 356. What are the benefits and costs associated with the requirements for relying on the underwriting exemption? What impact will these requirements have**

on capital formation, efficiency, competition, liquidity, price efficiency, if any? Please estimate any resulting benefits and costs or discuss why such benefits and costs cannot be estimated. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Please see our response to Question 348.

- **Question 357. What are the benefits and costs associated with the requirements for relying on the exemption for market making-related activity, including the requirement that such activity be consistent with the commentary in Appendix B? What impact will these requirements have on liquidity, price efficiency, capital formation, efficiency, and competition, if any? Please estimate any resulting benefits and costs or discuss why such benefits and costs cannot be estimated. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?**

  Please see our response to Question 348.

- **Question 358. What are the benefits and costs associated with the requirements for relying on the exemption for risk-mitigating hedging activity, including the requirement that certain hedge transactions be documented? What impact will these requirements have on liquidity, price efficiency, capital formation, efficiency, and competition, if any? Please estimate any resulting benefits and costs or discuss why such benefits and costs cannot be estimated. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?**

  Please see our response to Question 348.

- **Question 360. To rely on the exemptions from the proposed rule for permitted underwriting, market making-related activity, and risk-mitigating hedging, banking entities must establish, maintain, and enforce a compliance program, including written policies and procedures and internal controls. Please discuss how the costs incurred, or benefits received, by banking entities related to initial implementation and ongoing maintenance of the compliance program would impact their customers and their businesses with respect to underwriting, market making, and hedging activity.**

  Please see our response to Question 348.

- **Question 369. Please identify any cost savings that would be achieved through the use of an enterprise-wide compliance program. Alternatively, would you expect certain costs to increase when using an enterprise-wide compliance program? Please explain. Please identify any benefits that might be amplified or reduced when using an enterprise-wide compliance program.**

  Please see our response to Question 348.

- **Question 370. Are there tools or elements in the contents of the compliance program set forth in § .20(b) for which the costs may be negligible because banking entities**

use the same or similar elements for other purposes (e.g., satisfying other regulatory requirements, risk management, etc.) and could utilize existing infrastructure for purposes of the proposed rule? For example, could existing trader mandates or an existing training program be expanded to meet the requirements of the proposed rule, rather than developing an entirely new infrastructure? Alternatively, would the proposed rule require redundancies or duplications within a banking entity's infrastructure (e.g., the trader mandates currently used for one purpose do not conform to the requirements of the proposed rule, so a banking entity would have to utilize both in different circumstances)? Please identify and explain any such redundancies and how the rule could be modified to reduce or eliminate such redundancies, if possible.

Please see our response to Question 348.

- **Question 371. How would the proposed rule affect compliance costs (e.g., personnel or system changes) or benefits for each category of banking entity: small, medium, and large? Please discuss any differences between the costs and benefits of the compliance program required under § __.20(b) for smaller banking entities and the compliance program requirements of Appendix C for larger banking entities. Are the differences between these benefits and costs justified due to the differences in size and complexity of smaller and larger banking entities?**

  Please see our response to Question 348.

- **Question 373. How will the proposed definition of "covered fund" affect a banking entity's investment advisory activities, in particular activities and relationships with investment funds that would be treated as "covered funds"? Please estimate any resulting costs or benefits or discuss why such costs or benefits cannot be estimated.**

  Please see our response to Question 348.

- **Question 374. How have banking entities traditionally organized and offered covered funds? What are the benefits and costs associated with the proposed requirements for relying on the exception for organizing and offering covered funds? Please estimate any resulting costs or benefits or discuss why such costs or benefits cannot be estimated.**

  Please see our response to Question 348.

- **Question 375. What are the costs and benefits associated with the way the proposed rule implements the "customers of such services" requirement in the exception for organizing and offering covered funds? What alternative, if any, may be more cost-effective while still being consistent with the language and purpose of the statute?**

  Please see our response to Question 348.

- **Question 376. Is it common for a banking entity to share a name with the covered funds that it invests in or sponsors? If yes, what entity in the banking structure typically shares a name with such covered funds? What costs and benefits will result**

from the proposed rule's implementation of the name sharing requirement in exception for organizing and offering a covered fund? What alternatives, if any, may be more cost-effective while still being consistent with the purpose of the statute?

Please see our response to Question 348.

Please also see our response to Question 253 regarding whether the proposed rule effectively implements the prohibition on a covered fund sharing the same name or variation of the same name with a banking entity.

- **Question 377. Under what circumstances do directors and employees of a banking entity invest in covered funds? What are the benefits and costs associated with the proposed provisions regarding director and employee investments in covered funds? What alternatives, if any, may be more cost-effective while still being consistent with the purpose of the statute?**

  Please see our response to Question 348.

- **Question 378. Do banking entities currently invest in or sponsor SBICs and public welfare and qualified rehabilitation investments? If yes, to what extent? What are the benefits and costs associated with the proposed rule's implementation of the exception for investment in SBICs and public welfare and qualified rehabilitation investments?**

  Please see our response to Question 348.

- **Question 379. Do banking entities currently invest in or sponsor each of the vehicles that the proposed rule permits banking entities to continue to invest in and sponsor under section 12(d)(1)(J) of the BHC Act? If yes, to what extent? What are the benefits and costs associated with the proposed rule's implementation of these exceptions?**

  Please see our response to Question 348.

- **Question 380. For banking entities that are affiliated investment advisers, are there additional costs or benefits to complying with section 13 of the BHC Act and the proposed rule? For example, do affiliated investment advisers typically maintain records that would enable them to demonstrate compliance with the 3% ownership limits or restrictions on transactions that would be subject to sections 23A and 23B of the FR Act?**

  Please see our response to Question 348.

- **Question 381. Would complying with section 13 of the BHC Act and the proposed rule affect an affiliated investment adviser's other business activities (benefit or burden) that are not subject to restrictions on proprietary trading or other covered fund activities? For example, would advisers incur additional burdens to distinguish covered fund activities from non-covered fund activities?**

Please see our response to Question 348.

- **Question 382. For banking entities that are affiliated investment advisers, are there particular costs or benefits to complying with the portions of Appendix C that are applicable to each asset management unit of the adviser? Do these costs and benefits differ depending on whether the adviser complies with Appendix C individually or on an enterprise basis? Does the rule provide sufficient clarity for how Appendix C applies to unregistered affiliates of an affiliated investment adviser?**

Please see our response to Question 348.

IX. SEC: Additional Matters

A. Statutory Authority and "Covered Banking Entity" Definition

2. "Covered Banking Entity" Definition

The SEC requests comment on the proposed definition of "covered banking entity." In particular, the SEC requests comment on the following questions:

- **Question SEC-1. Is the SEC's proposed definition of the term "covered banking entity" sufficiently clear? If not, why not? Please suggest an alternative definition.**

Please see our response to Question 5 regarding the proposed rule's definition of "banking entity."

- **Question SEC-2. Is the SEC's proposed definition of the term covered banking entity appropriate, or is it over- or under-inclusive? Please explain.**

Please see our response to Question 5 regarding the proposed rule's definition of "banking entity."

- **Question SEC-3. Should any of the covered banking entities included in the SEC's proposed definition of "covered banking entity" be excluded? If so, which entities, why, and on what basis? Should the SEC's proposed rule provide specific guidance or exemptions for any such entities?**

Please see our response to Question 5 regarding the proposed rule's definition of "banking entity."

- **Question SEC-4. Would particular types of entities incur costs or burdens that are greater than other types of entities that are included in the SEC's proposed definition of "covered banking entity"? If so, should any such difference be addressed or mitigated? How?**

Please see our response to Question 348.

B. Consideration of the Impact of Reporting and Recordkeeping and Compliance Program Proposed Rules on Competition and on the Promotion of Efficiency, Competition and Capital Formation

- **The SEC requests comment on the competitive or anticompetitive effects of the elements of the proposed rule that are proposed under Exchange Act authority with respect to covered banking entities that are registered broker-dealers and security-based swap dealers. The SEC also seeks comment on the efficiency and capital formation effects of these components of the proposal, if adopted. The SEC encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such effects.**

  Please see our response to Question 348.

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Note on Merchant Banking Investments.

The proposed rules properly construe the Volcker Rule to apply only to proprietary trading and investing in, sponsoring or entering into covered transactions with hedge funds or private equity funds. They do not attempt to expand the Volcker Rule to disturb the pre-existing authority of bank holding companies to make controlling or noncontrolling investments in or enter into covered transactions with financial or nonfinancial companies other than hedge funds or private equity funds, including pursuant to the merchant banking authority in Section 4(k)(4)(H) of the BHC Act and its implementing regulations in Subpart J of the Board's Regulation Y. There is no basis in the text or legislative history of the Volcker Rule to expand it to apply to these other investments or relationships. Public statements to the contrary made after the Volcker Rule was enacted do not constitute legislative history.