SUBMITTED ELECTRONICALLY

March 31, 2020

Jerome H. Powell, Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Joseph M. Otting, Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, D.C. 20219

Heath P. Tarbert, Chairman
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, D.C. 20551

Jay Clayton, Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Jelena McWilliams, Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Dear Chairmen Powell, Tarbert, McWilliams, and Clayton; and Comptroller Otting:

The American Investment Council (the "AIC") appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission (collectively, the "Agencies") on the notice of proposed rulemaking (the "Proposal") on revisions to the Agencies' regulations (the "Final Regulations") implementing section 13 of the Bank Holding Company Act of 1956 (the "BHC Act"), commonly referred to as the "Volcker Rule."[1]

The AIC is an advocacy, communications and research organization established to advance access to capital, job creation, retirement security, innovation and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes and distributes information about the private equity and private

[1] 85 Fed. Reg. 12120 (Feb. 28, 2020).

credit industry and its contributions to the U.S. and global economy. Established in 2007 and formerly known as the Private Equity Growth Capital Council, the AIC is based in Washington, D.C. The AIC's members are the world's leading private equity and private credit firms, united by their commitment to growing and strengthening the businesses in which they invest.[2]

Although most of our member private equity and private credit funds ("private equity funds") are not directly subject to the Final Regulations, the Final Regulations have affected our members by making it more difficult to raise funds from investors – such as non-U.S. banks investing from abroad and U.S. banks investing in third-party funds – that were not intended to be limited by the Volcker Rule. To this end, we appreciate the Agencies' efforts to simplify and tailor the Final Regulations through the Proposal by eliminating or modifying requirements that are not necessary to implement the statute's mandate and requirements. We also appreciate that the Proposal would expand the exclusions from the "covered fund" definition to facilitate investments in credit and venture capital funds with long-term investment strategies, which funds the Volcker Rule was not intended to restrict investments in. However, as we explain below, we think that an additional exclusion is necessary to ensure consistent treatment for other long-term investment funds that may not be able to avail themselves of the credit or venture capital funds exclusions. Such funds are, like credit and venture capital funds, long-term investment vehicles that do not represent the types of vehicles the Volcker Rule was intended to restrict investments in, nor would permitting investments in such funds run counter to any of the Agencies' stated policy objectives.

In this letter, we explain our support for aspects of the Proposal of particular interest to our members and how certain changes to the Proposal are necessary to more efficiently achieve the Agencies' policy objectives and, in turn, eliminate unnecessary burdens on long term-investment funds and their investors.

I. Covered Fund Exclusions for Long-Term Investment Funds

Although we appreciate the Agencies' new exclusions for venture capital and credit funds, which we think reflect the Agencies' thoughtful consideration of the need to more appropriately tailor the covered fund exclusions to better align with the purposes of the Volcker Rule, we think that the Agencies should provide an additional exclusion for investments in long-term investment funds. As we explain below, we think that such an additional exclusion, about which the Agencies ask in Question 50 in the Proposal, would help ensure consistent treatment between similar investment vehicles, which we believe is necessary to maintain a level playing field and avoid one type of long-term investment fund being arbitrarily, or even

2 For further information about the AIC and its members, please visit our website at http://www.investmentcouncil.org.

unintentionally, favored over another, which would create market dislocations and incentives for unwarranted regulatory arbitrage.

A. The Agencies should adopt an additional exclusion for investments in long-term investment funds that are not qualifying venture capital funds or credit funds.

The Agencies request comment on whether to exclude from the definition of covered fund long-term investment funds that would not be qualifying venture capital funds (Question 50). In particular, the Agencies ask whether an exclusion from the covered fund definition should be provided for funds that: (1) make long-term investments that a banking entity could make directly; (2) hold themselves out as entities or arrangements that make investments intended to be held for a set minimum time period, such as two years; (3) whose relevant offering and governing documents reflect a long-term investment strategy; and (4) that meet all the other requirements of the proposed qualifying venture capital exclusion, but for the fact that they do not fall under the definition included in 17 CFR § 275.203(l). For the reasons stated below, we strongly believe that the Agencies should exclude such funds from the covered fund definition.

First, we believe that this additional exclusion would help ensure consistent treatment of funds with long-term investment strategies and maintain a level playing field, without arbitrarily, or even unintentionally, favoring one type of long-term investment fund over another. In proposing the venture capital fund exclusion, the Agencies stated as a goal to promote "a more diverse array of long-term investments in a broader range of geographic areas, industries and sectors."[3] Long-term investment funds that satisfy the criteria set forth in Question 50 also would accomplish the Agencies' stated objective. There is no sound policy rationale for restricting investments in these types of long-term investment funds but permitting investments in venture capital funds. This, in our view, arbitrarily favors one segment of the long-term fund industry over another. In fact, in the preamble to the Agencies' 2014 final regulation implementing the Volcker Rule, the Agencies recognized that there is no meaningful or rational distinction between venture capital and private equity funds and, for this reason, the two types of vehicles demand the same Volcker Rule treatment.[4] Respectfully, nothing has changed since that time to warrant a different regulatory posture.

Both venture capital and other long-term investment funds, moreover, make investments that a banking entity would be able to make directly on its balance sheet.

[3] 85 Fed. Reg. at 12137.

[4] 79 Fed. Reg. 5536, 5704 (Jan. 31, 2014) (recognizing that venture capital funds and private equity funds "are not readily distinguishable" and explaining that Congress "explicitly recognized and treated venture capital funds as a subset of private equity funds").

Permitting banking entities to make indirect investments through a venture capital fund (and thus syndicate and lower their risks when making venture capital investments) but not through other long-term investment funds (thereby leaving the banking entity with full exposure to these long-term investments), would actually limit a banking entity in its ability to make more prudent investment decisions and manage risks. There is no policy justification for this disparate treatment, which strikes us as arbitrary and capricious.

To the extent that the Agencies believe that this additional exclusion would be overbroad, we respectfully disagree. The types of investment vehicles the Volcker Rule was meant to target would still be subject to the covered funds restrictions. For instance, hedge funds and any private equity funds that engage in short-term trading activities would continue to be treated as covered funds, as this exclusion would not be available for such funds. Rather, the additional exclusion for long-term investment funds would only permit banking entities to invest in funds engaged in activities that are already permissible for a banking entity under current law and enable banking entities to "promote the benefits of long-term investment that the agencies and Members of Congress have previously recognized."[5] Particularly given the COVID-19 crisis, we think that promoting ways in which banking entities can make long-term investments and support companies makes policy sense.

Moreover, as contemplated by the criteria in Question 50, the exclusion also would explicitly prohibit the fund from engaging in proprietary trading, prohibit the banking entity from guaranteeing, assuming, or otherwise insuring the obligations or performance of the fund, and include any other restrictions to ensure a banking entity's investment in and relationship with the long-term investment fund is conducted in accordance with applicable law and safety and soundness standards. These limits are sound, and we support them.

For these reasons, we think the Agencies should adopt an additional exclusion for long-term investment funds that meet the requirements set forth in Question 50. As the Agencies recognize by considering the additional exclusion described in Question 50, it makes no sense to draw an artificial line between venture capital funds and other long-term investment funds—both of which pursue the same long-term investment strategies. Creating such a distinction, and drawing on regulatory definitions that, for other purposes, may divide these two types of funds, would be a poor and unwarranted policy choice.

B. The Agencies should adopt the proposed exclusions for credit and venture capital funds.

We generally support the Agencies' new exclusions for credit and venture capital funds, which, like other long-term investment funds, are vehicles that do not engage

[5] 85 Fed. Reg. at 12137.

in the types of short-term trading activities that the Volcker Rule was principally designed to address.

1. *Credit Funds*

Under the Proposal, a credit fund would be permitted to invest in loans and other debt instruments. The fund would also be able to hold rights and other assets that are related or incidental to such loans or debt instruments. These vehicles represent an important source of credit that facilitates innovation and economic growth, and we are encouraged that the Agencies are seeking to remove unnecessary barriers to investment in such vehicles.

The Agencies request comment on whether the credit fund exclusion should include a quantitative limit on permissible non-loan and non-debt assets (Question 29). We do not think that such a limit is necessary. Any rights or assets related or incidental to loans or debt instruments held by the credit fund would be limited to be cash equivalents, securities received in lieu of certain debts, or certain equity securities (or rights to acquire equity securities) received on customary terms in connection with the credit fund's loan or debt holdings. Thus, the holding of those non-loan and non-debt assets (or rights) does not raise concerns that banking entities may use credit funds to evade the Volcker Rule, given that such assets may be held *only* when received on customary terms in connection with a loan or other debt instrument.

2. *Venture Capital Funds*

We support the Agencies proposed exclusion for qualifying venture capital funds, which represent a critical source of financing to small businesses and startups. We would like to reiterate, however, that the Agencies should adopt an additional exclusion for other long-term investment funds, which also are an important source of funds to companies in all stages of their growth cycles.

The views expressed by Congress in the statements cited in the Proposal give venture capital funds as *examples* of the type of long-term investment vehicles that should not be captured by the Volcker Rule's restrictions. As Representative Eshoo noted, Congress expected that regulators would "use the broad authority in the Volcker Rule wisely and clarify that funds…*such as* venture capital funds, are not captured under the Volcker Rule."[6] We urge the Agencies to use the authority granted to them by

[6] 156 Cong. Rec. E1295 (daily ed. July 13, 2010) (emphasis added) (statement of Rep. Eshoo) ("the purpose of the Volcker Rule is to eliminate risk-taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest…Venture capital funds do not pose the same risk to the health of the financial system. They promote the public interest by funding growing companies critical to spurring innovation, job creation, and economic competitiveness. I expect the regulators to use the broad authority in the Volcker Rule wisely and clarify that funds…such as venture capital funds, are not captured under the Volcker Rule and fall outside the definition of 'private equity.'").

Congress to exclude both long-term investment funds that meet the criteria set forth in Question 50 and venture capital funds equally from the Volcker Rule. This approach would accord with congressional intent and recognize that such long-term investment funds and venture capital funds are substantially similar long-term investment vehicles that ought not to be treated differently for Volcker Rule purposes.

II. Codification of Existing Guidance on the Marketing Restriction.

We appreciate the Agencies' clarification that the Proposal does not modify or revoke any "frequently asked questions" ("FAQs") previously issued by the staffs of the Agencies.[7] We write, however, to stress the importance of FAQ #13 to our members, which we believe should be codified in any final rule for the reasons stated below.

The Final Regulations include an exemption for non-U.S. banking entities and their investments in covered funds outside the United States so long as no ownership interest is "offered for sale or sold to a resident of the United States" and any acquisition, retention or sponsorship is conducted "solely outside of the United States" (the "SOTUS" exemption).[8] Under the Final Regulations as currently written, the requirement that an ownership interest may not be "offered for sale or sold to a resident of the United States" (the "marketing restriction") was not clear whether it only applied to the investing non-U.S. banking entity (so that the entity could not market fund shares into the United States) or more broadly to third-party sponsors such as our members (in which case, non-U.S. banking entities would not be able to invest in funds that were offered also to U.S. investors).

After significant time and effort spent by the AIC and other industry members to communicate on this issue, the Agencies' staffs issued FAQ #13 to clarify that the marketing restriction only applies to the activities of a foreign bank and not of unaffiliated third-party sponsors. Thus, this guidance enables foreign banks to invest in covered funds alongside U.S. investors. The FAQ also notes that non-U.S. banking entities that sponsor or serve as investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund would be deemed to participate in an offer or sale of ownership interests to U.S. residents.

We support codification of FAQ #13 because it would provide greater clarity and certainty for non-U.S. banks to make investments in third-party sponsored funds in reliance on the SOTUS exemption, consistent with the Agencies' goal to "better limit

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[7] 85 Fed. Reg. at 12123.

[8] *See* Final Regulations §§ _.13(b)(1)(iii), (iv).

the extraterritorial impact" of the Final Regulations.[9] As we have stated previously, codification would provide complete confidence to our members (and non-U.S. bank investors) that this interpretation is here to stay and long-term strategies will be able to rely on this guidance.

III. Qualifying Foreign Excluded Funds

We appreciate that the Proposal seeks to address the excessive extraterritorial impact of the Final Regulations and more closely align the Final Regulations with the statutory purposes of the Volcker Rule.[10] We agree with this objective of the Agencies. Currently, the Final Regulations permit non-U.S. banking entities to rely on the SOTUS exemption to invest in non-U.S. funds that are not covered funds (so called "foreign excluded funds"). However, the significant issue that has emerged is that a foreign excluded fund, if it is 25% or more owned by a banking entity, may be treated as an affiliate of the investing banking entity and, therefore, would be subject to the limits and restrictions of the Volcker Rule.[11]

This treatment is untenable for many funds and at odds with their core purpose to invest in financial instruments and other assets. As a result, non-U.S. banks' investments in foreign excluded funds and other non-U.S. vehicles may be artificially and unnecessarily limited and/or needless compliance burdens may be foisted on fund sponsors (which need to ensure that funds comply with the Volcker Rule's limits) and costs imposed on other fund investors. This treatment achieves no legitimate policy purpose and merely thwarts the Volcker Rule's clear objective of seeking to avoid disruptions to non-U.S. banking entities' non-U.S. investment activities. This issue is avoided for covered funds because the Final Regulations expressly carve out those funds from the banking entity definition.[12]

Importantly, the Proposal would effectively codify current no-action relief that the Agencies have provided for so-called "qualifying foreign excluded funds" ("QFEFs") that meet certain criteria. Under this no-action relief, the Agencies do not regard a QFEF as a banking entity, and therefore such funds are not subject to the Volcker

9 85 Fed. Reg. at 12123.

10 *Id*. at 12125 (explaining that "[s]ection 13(d)(1)(H) and (I) of the BHC Act permit foreign banking entities to conduct certain trading and investing activities outside the United States" and that "the purpose of these statutory provisions is to limit the extraterritorial application of section 13 as it applies to foreign banking entities").

11 Final Regulations at § _.2(a) (referencing the BHC Act definition of affiliate, 12 U.S.C. § 1841(k)).

12 *Id*. at § _.2(c)(2)(i).

Rule's prohibitions.[13] This relief has been repeatedly extended by the Agencies and is set to expire on July 21, 2021.

We appreciate that the Agencies recognize the treatment of foreign excluded funds as banking entities is an unintended consequence of the Final Regulations and are now seeking to codify this important relief. This relief is necessary to avoid imposing burdens and limits on private equity fund sponsors, which burdens and limits serve no apparent policy purpose. Further, as stated above, this treatment would be consistent with the Agencies' stated efforts to "limit the extraterritorial application" of the Final Regulations.

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Thank you for considering these comments. If you have any questions or would like additional information, please feel free to contact me at 202-465-7700.

Respectfully submitted,

Jason Mulvihill

Jason Mulvihill
Chief Operating Officer and General Counsel
American Investment Council

[13] Technically, the Proposal does not carve QFEFs out of the banking entity definition; rather, a QFEF that meets the relevant criteria is effectively treated as a non-banking entity because the QFEF is not subject to the restrictions in §§ _.3(a) and _.10(a). *See* Proposal at §§ _.6(f) and _.13(d).