J.P.Morgan
Asset Management

George C.W. Gatch
Managing Director
CEO - Global Funds Management
& Institutional

April 6, 2018

Anna Harrington, Senior Supervisory Financial Analyst
Board of Governors of the Federal Reserve System
20th St and Constitution Avenue, NW
Washington, DC 20551

Re: Seed capital restrictions for registered U.S. and foreign mutual funds; foreign public funds

Dear Ms. Harrington:

In consideration of indications that the Board of Governors of the Federal Reserve System ("FRB") and the other financial regulators with joint authority (together, the "Agencies") over the implementation of section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the regulations thereunder (referred to herein as the "Volcker Rule" or the "Rule") are exploring possible revisions to the Rule, we write to provide commentary on the Rule's restrictions with respect to the seeding of registered U.S. investment companies and foreign public funds (together, "mutual funds"), and the Rule's exclusion of "foreign public funds" ("FPFs") from the definition of "covered fund." This letter focuses on certain priority issues under the Volcker Rule for J.P. Morgan Asset Management ("JPMAM")[1], and should not be read as an indication of the priorities of JPMorgan Chase & Co. and its other subsidiaries with respect to the Rule.

JPMAM is the second-largest bank-affiliated manager of mutual funds globally, with $544 billion in assets under management ("AUM") in long term assets and an additional $424 billion in money market funds, and is the largest bank-affiliated fund manager offering predominantly actively-managed products.[2] As a leading provider of mutual funds both domestically and abroad, the ability to develop and offer new mutual funds to meet changing client demands and market conditions is critical to our ongoing success. The seed capital limitations for registered funds under the Volcker Rule have negatively impacted our product strategy and pipeline, and therefore our ability to compete with non-bank-affiliated asset managers in the United States and globally.[3] We do not believe this was the intent of the Volcker Rule.

[1] J.P. Morgan Asset Management is a marketing name for the investment management subsidiaries of JPMorgan Chase & Co.

[2] Source: Long term AUM: Strategic Insight, as of January 2018 for U.S. and December 2017 for non-U.S; Liquidity AUM: JPMAM data as of December 2017. While JPMAM, like many other managers, offers both actively managed and passively managed funds, for reasons articulated later in this letter actively managed strategies are more likely to require a sufficient track record before distributors will consider adding them to a platform.

[3] In light of FAQ 16's reference to a seeding period of "for example, three years" and in the absence of affirmative indications of when the seeding period may exceed three years, we have generally limited seed capital investments of 25

Additionally, in our experience, the treatment of non-U.S. registered funds is excessively, and unnecessarily, restrictive. Specifically, the "foreign public fund" exclusion from the definition of covered fund is too narrow and may not be available to funds that we believe are similar to U.S. registered investment companies ("RICs"), and therefore fails to provide comparable treatment for U.S. and non-U.S. registered funds as the Rule intended. In some instances, these challenges have necessitated treating non-U.S. registered funds as covered funds, with the attendant limitations on the funds' name and ability to conduct certain transactions with affiliates, among others. In other cases, the Rule's complex requirements and activity constraints have necessitated burdensome compliance programs. We believe these restrictions do not further the intent of the FPF exclusion or of the Rule as a whole.

Below we describe the challenges created by the seed capital limitations and the FPF definition, and offer recommendations for lessening these impacts, consistent with our understanding of the intent of the Rule. In summary:

<u>Seed capital limitations</u>:

- Developing and testing new mutual fund investment strategies, and then gathering assets to bring a fund to scale and reduce a fund sponsor's seed capital below the relevant threshold, can take time, especially for innovative funds. The seed capital limitations for registered funds under the Volcker Rule have negatively impacted JPMAM's product strategy and pipeline, and our ability to compete with non-bank-affiliated asset managers in the United States and globally.
- We believe the Rule's intent – to prevent a banking entity from using a seeded fund to conduct prohibited proprietary trading – could be achieved without imposing a time limit on the permissible seeding period. We recommend that seeded RICs and FPFs not be treated as banking entities if they are formed and operated pursuant to a written plan to 1) test proposed or existing investment strategies for potential investment by third-party investors, and 2) market the fund to such investors.

<u>Foreign public funds</u>:

- The Rule's exclusion for FPFs is too narrow, and fails to provide comparable treatment for U.S. RICs and substantially similar non-U.S. registered funds, as the Rule intended. To align the treatment of non-U.S.-registered funds to their U.S. counterparts, we recommend that the Agencies:
    - Clarify that the "home jurisdiction" of a FPF constitutes either the jurisdiction in which the issuer is organized, or any other jurisdiction in which ownership interests are offered or sold in a public offering;
    - Revise the "predominantly through one or more public offerings" element of the FPF exclusion to require that a fund be authorized for sale to the public in one or more jurisdictions outside of the United States; and

---

percent or more of the interests in a fund to three years. *See* Volcker Rule Frequently Asked Questions, available at https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm.

- Align the limitations on ownership of a FPF by the sponsoring banking entity and issuer, their affiliates, directors, and employees, after the permissible seeding period, with the treatment for U.S. RICs (*i.e.*, together less than 25 percent, with directors' and employees' holdings not considered).

Seed Capital Limitations

Background: Starting a Mutual Fund

Mutual funds start as concepts – that is, ideas for investment products that address present or future needs of investors. These concepts can come from a variety of sources. For example, a client might request that we offer a particular strategy; our product strategy team might observe a competitor's fund doing well or, conversely, an unmet demand in the market; or a portfolio manager or market strategist may conceive of a new concept, such as one to meet a particular client need or market condition. Recently, there has been growth in new products that are solutions-oriented – that is, they are managed to meet a particular need, such as retirement or college savings, rather than investing in a single asset class (*e.g.*, equities) for use in a diversified client portfolio.

At JPMAM, the process for evaluating these concepts and ultimately bringing them to market is robust. First, a concept is developed and analyzed, and the business case is built – that is, we consider the product's target market, relevant benchmark, pricing, and expected capacity, among other things, and decide whether the concept is worth pursuing as a business matter. After our internal governance process clears a new product to proceed, the new fund is reviewed and approved by a fund board, which has a fiduciary obligation to act in the best interest of fund shareholders. At the same time, filings are submitted with the regulatory bodies charged with substantive oversight of the fund's activities. In the United States, for example, a registration statement for the fund is filed with the Securities and Exchange Commission (the "SEC") for review and comment. The registration statement describes, among other things, the fees, strategy, and risks of the fund.

Concurrent with the regulatory filings, JPMAM begins the operational setup for the fund. At the same time, our seed capital committee reviews the request for seed capital to ensure it is sufficiently limited and can be properly managed and monitored. Once these steps are complete and the fund is registered or authorized by the relevant regulator (*e.g.,* registered with the SEC in the case of a RIC), a seed capital investment (and any other funding[4]) is placed in the fund and the strategy is implemented.

As part of JPMAM's fund governance process, seeded funds are reviewed semi-annually after the first year, with specific consideration of whether the fund should be launched (*i.e.*, actively distributed to the public), liquidated, or left in the seed stage. The decision to seek client investment in a fund is not one we take lightly. Bringing to market a fund that does not ultimately succeed results in a negative client experience (*e.g.*, disruption to the client's investment portfolio, potential

[4] At times a client or series of clients will request that we launch a particular strategy, and will invest in the fund at its outset. To ensure that there is funding on Day 1 and to address client concentration concerns, JPMAM adds seed capital to such funds.

capital losses or capital gains taxes, etc.), as well as reputational damage to the firm and the financial advisers recommending the fund. Thus, in the United States, we frequently operate funds with 100 percent seed capital, and do not accept outside investment until we are optimistic the fund will succeed, considering factors such as anticipated demand, market conditions, marketing planning, and engagement with distributors. In Europe, by contrast, we are not permitted to refuse client investments, so some funds take in small amounts of client assets while still under seeding review.

Growing a fund to sufficient scale such that JPMAM seed capital can be meaningfully reduced without harming shareholders can take a substantial amount of time, even in the best of circumstances. Nonetheless, consistent with our interpretation of the Rule and the FAQs, we seek to reduce seed capital investments to below 25 percent of a fund's AUM (or 15 percent for a FPF) within three years. In order to meet this timeline, we typically make the "launch or liquidate" determination between 24 and 30 months after the fund is started. As discussed in more detail below, in many cases this is simply not enough time to properly assess the potential of a new strategy.

Distribution Challenges – Accumulating Assets in a New Fund

A critical factor in our determination to launch a fund is confidence that we can accumulate sufficient assets to reduce our seed capital investment within the permissible seeding period. The larger the fund, the less capital needs to be withdrawn; conversely, removing seed capital from a fund that is of insufficient scale can have a range of negative impacts such as capital gains distributions to remaining investors from the sale of assets, inability to effectively implement a diversified strategy, and increased ownership concentration. In turn, these effects can lead to additional investor redemptions and create a downward spiral, potentially driving a fund's AUM below distribution platforms' minimum threshold for sales, and necessitating closure of the fund.[5]

Most asset managers, including JPMAM, are heavily reliant on separately organized distributors and intermediaries (*e.g.*, broker-dealers and investment advisers) to gather assets.[6] With over eight thousand funds available in the United States alone,[7] fund distributors are extremely selective in the funds they choose to sell; indeed, in the past year many distributors have reduced the number of funds made available on their platforms.[8] With such a wealth of product offerings, distributors have understandably been reluctant to make exceptions to their due diligence and fund selection process

[5] Indeed, JPMAM closed its U.S. Research Equity Plus fund after a similar scenario played out in 2015, despite the fund's 5-star rating from Morningstar and substantial outperformance of its benchmark (the S&P 500) in the calendar year prior to liquidation.

[6] A small portion of mutual funds are purchased by investors directly from the fund manager, negating the need for an intermediary. At JPMAM, less than 1 percent of our AUM comes from direct purchases.

[7] 2017 Investment Company Institute Factbook at 174, available at www.icifactbook.org.

[8] *See, e.g.*, "UBS Culling More Than 800 Mutual Funds," *Ignites*, March 14, 2018; *see also* "Morgan Stanley Yanking Hundreds of Funds From Menu," *Ignites*, Jan. 29, 2018 (reporting that Morgan Stanley Wealth Management is planning to remove 600 funds from its fund platform; the article further notes that Merrill Lynch cut its platform nearly in half last year, Voya Financial and Ameriprise also cut their offerings, and LPL Financial and RBC Wealth Management are undergoing similar reviews).

for bank-affiliated fund sponsors; nor, it should be noted, would rushing products to market benefit end investors.

Distributors consider a range of factors in their due diligence and fund selection process. Chief among them is a fund's performance track record. As a general rule, distributors will not even consider a fund for distribution, *i.e.*, will not begin the due diligence process, until a fund has a three-year track record, meaning that it could be three and a half or even four years before a fund is made available for sale on a platform. There are some exceptions to this rule – for example, funds that track an established market index can be back-tested for performance, so if a distributor has confidence in the manager's ability to effectively track indices, such funds may be considered earlier. Additionally, at times distributors make exceptions for new strategies that meet an unfilled need of the distributor's clients, such as liquid alternatives in recent years. By contrast, novel funds such as many outcome-oriented products (*e.g.*, those designed for retirement or college savings) may take even longer to demonstrate they are ready for distribution. Smaller intermediaries, such as independent broker-dealers and registered investment advisers, are more likely to make exceptions than large broker-dealers; however, smaller intermediaries also tend to drive smaller flows, so such exceptions by themselves may be insufficient to help a fund reach a viable scale.

In addition to track record, distributors typically consider a fund's current AUM, as well as distributor concentration (*i.e.*, how many distributors are responsible for the fund's AUM). As noted above, funds with insufficient AUM to be managed efficiently may spiral into closure, with negative client impacts as well as potential reputational repercussions for any distributor that recommended or sold the fund. Thus, distributors will often require that funds have $50-100 million in AUM before adding them to a platform. Distributors also typically establish concentration limits – they will not hold more than, for example, 25 percent of a fund's AUM, to preserve their flexibility to withdraw all of their assets from the fund without creating liquidity challenges; likewise, they will want assurances that no other single distributor could cause such an impact. Should their concentration exceed the limit due to movements by other investors, a distributor may withdraw assets, putting further downward pressure on a fund.

These requirements make it challenging for asset managers to remove seed capital within three years, even from a well-performing fund. Indeed, asset managers may even wish to inject additional seed capital into a promising fund in its third year to meet or maintain minimum asset and concentration thresholds. Of course, a capital injection increases the challenge of reducing the manager's ownership below 25 percent within three years.

In part as a result of these challenges, JPMAM has launched many fewer funds since the Volcker Rule became effective than in past years. For example, in the United States, we launched 16 funds between 2014 and 2016, compared to 34 between 2011 and 2013. Perhaps more importantly, these challenges dramatically impacted our forward-looking product strategy efforts, as discussed in more detail below.

Impact of Challenges on Product Strategy and Development

JPMAM's ability to serve its clients effectively is in large part premised on our ability to meet their current and future investment needs. Because of the challenges described in this letter, we are concerned about our ability to pursue and successfully launch new strategies to meet client needs.

Specifically, the Volcker Rule constraints have shifted our focus in product strategy, including by requiring JPMAM to disproportionately consider a product's short-term viability relative to its long-term potential. We believe this short-term focus will negatively impact our long-term ability to serve our clients effectively, relative to non-bank-affiliated asset managers.

This undue focus on short-term viability can result in missed opportunities and competitive disadvantage in several ways. First, to conform to our interpretation of the Rule and FAQs, JPMAM has liquidated a number of funds in which it had a high degree of confidence, because the funds have not gained assets quickly enough.[9] For example, in 2017 we liquidated both a U.K.-domiciled and a Luxembourg-domiciled version of the J.P. Morgan Global Allocation Fund. This strategy has been highly successful in the United States, gathering over $3 billion in AUM since its launch in 2011, and we were optimistic about its potential in the United Kingdom and continental Europe. Because it is a flexible, multi-asset strategy with an outcome-orientation, however, we found that it took longer than expected to educate distributors and investors, with the result that the funds did not gather sufficient assets within three years.[10]

Second, we are limited in our ability to develop products designed for specific market environments or events. For example, in 2015 we liquidated two liquidity funds – a floating NAV money market fund and an ultra-short bond fund – because they had been seeded for three or more years but did not appear to be commercially viable. Their prospects may well have changed after the SEC's money market fund reform took effect in 2016,[11] or if interest rates had risen during that period. While non-bank-affiliated asset managers would have the option to keep seed capital in such funds until such time as they could effectively attract third-party assets (*e.g.*, when interest rates rise, which they inevitably will), without that flexibility we chose not to open the funds to clients and run the risk of having to subsequently liquidate them.

Finally, the need for short-term viability can limit our success with novel products. Historically, the first movers in new product offerings have typically been the most successful at raising assets; however, developing and marketing these products takes time that we may not have due to the Rule's restrictions on seeding periods. Current examples at JPMAM include decumulation products, which allow retirees to spend down their savings at a measured pace without purchasing an insurance product. Such products are challenging to engineer but are expected to be in high demand as baby boomers retire.

At the end of 2016, JPMAM seeded and launched the "SmartSpending 2050" fund to meet this anticipated need. Since that time, we have been developing a track record and proof of concept, while also ensuring the market is operationally ready to support this product (mutual funds have

---

[9] Overall, the Rule has been a dominant factor in the decision to liquidate approximately 15 JPMAM mutual funds globally.

[10] Similarly, in 2017 we liquidated the U.K.-domiciled version of our Income Fund, which has been successful both in the United States (garnering approximately $225MM) and continental Europe (approximately $125MM).

[11] *See, e.g.,* "Ultra-Shorts Attract Assets, SEC Scrutiny Post-Money Fund Reform," *Ignites*, Feb. 12, 2018 (reporting that $40B moved into ultra-short bond funds last year as a result of the SEC's money market fund reforms).

historically been solely accumulation vehicles, so regular payouts are not typical). Several non-bank-affiliated competitors are also developing these products.

If history is any indication, the eventual market leaders in decumulation products are currently among this group of early adopters; while other providers may replicate the strategy, they will likely not overtake the early adopters in AUM. However, amongst this group, only JPMAM will be forced to prove its concept, ensure market readiness, educate consumers, market the fund, and reduce our seed capital investment below 25 percent without sending the fund into a downward spiral, all within a seeding period limited by the Volcker Rule. If we are unable to do so and must liquidate this fund, we may well attempt the strategy again at a later date after the market is properly conditioned, but we will have lost our early adopter advantage.

This is clearly a competitive disadvantage for JPMAM, but it may also have a negative impact on our clients and the market. JPMAM has historically been a strategic leader and early adopter of novel investment strategies. While our non-bank-affiliated competitors will no doubt continue to attempt new strategies, constraining talented innovators such as JPMAM from participating fully in the competition can only have negative effects.

Recommendation

As noted above, in light of FAQ 16's reference to a seeding period of "for example, three years" and in the absence of affirmative indications of when the seeding period may exceed three years, we have generally limited seed capital investments of 25 percent or more of the interests in a U.S. RIC, or 15 percent or more of the interests in a FPF, to three years. We understand that this is a commonly held interpretation, despite some uncertainty as to the intent of the FAQ.

We recommend that the Agencies revise their regulations[12] to clarify that RICs and FPFs will not be treated as banking entities solely by virtue of being controlled by a banking entity that serves as an investment adviser or sponsor of the fund and holds an ownership interest in the fund, during a permissible seeding period. We do not believe a time limit should be placed on the permissible seeding period; however, to ensure that the exclusion is relied upon solely for the purpose of product development and marketing, the exclusion could be limited to those RICs and FPFs formed and operated pursuant to a written plan to 1) test proposed or existing investment strategies for potential investment by third-party investors, and 2) market the fund to such investors. We believe that these requirements, together with the regulatory regimes to which registered funds are subject, would effectively limit the ability of a banking entity to use a seeded fund to evade the requirements of the Rule and impose practical constraints that disincentivize the use of registered funds in such a manner.

---

[12] Given the ongoing challenges described in this letter, and the potentially lengthy process of revising the Rule, we would also welcome guidance in the interim clarifying that a RIC or FPF will not be deemed a banking entity so long as it continues to be seeded on a *bona fide* basis and not for the purpose of evading the requirements of the Rule. We believe that this clarification would be consistent with, and is necessary to resolve the uncertainty arising from, FAQ 16's reference to a three-year seeding period as an "example" of, and not a limitation upon, the period of time during which a RIC or FPF may be seeded without being deemed a banking entity.

J.P.Morgan
Asset Management

Foreign Public Funds

In adopting the regulations implementing the Rule, the Agencies explained that the FPF exclusion was "designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of [the Volcker Rule], including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States."[13] As a global asset manager with a strong retail franchise, our experience suggests that the practical effects of the Rule have not been consistent with this intent. We note below three requirements of the FPF exclusion – "home jurisdiction," "predominantly through one or more public offerings outside the United States," and "predominantly to persons other than the sponsoring banking entity, issuer, affiliates, directors and employees" – that have presented logistical and/or interpretive challenges; we believe each requirement could be clarified or revised while preserving the intent of the Rule.[14]

"Home Jurisdiction" Requirement

To qualify for the FPF exclusion, a fund must be, among other things, "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction."[15] The Agencies explained that this condition is intended to ensure that a non-U.S. fund would qualify for the foreign public fund exclusion only if it is sufficiently similar to a RIC in terms of the securities laws and investor protection regime that apply to the foreign public fund.[16]

The Rule does not define "home jurisdiction," nor has any interpretive guidance been published in this respect. Absent any such guidance, our practice – and that of the industry, as we understand it – has been to interpret "home jurisdiction" as the jurisdiction in which a fund is domiciled. This requirement, however, serves to exclude funds that were, we believe, intended to benefit from the exclusion: funds designed for sale to retail investors and subject to local securities laws and substantive investor protection regulation in the jurisdictions in which they are registered or authorized for sale to retail investors (but which are not so registered or authorized in their jurisdiction of domicile).

---

13 79 Fed. Reg. 5536, 5678 (Jan. 31, 2014).

14 The concerns articulated below are provided from the perspective of a fund sponsor (JPMAM). We understand from our affiliated broker-dealer and their trade organizations that, because of the interpretive and logistical challenges we describe, it is difficult for them to determine with certainty whether a fund qualifies for the FPF exclusion. For purposes of market marking and trading in these funds, this determination is important because of the capital charges associated with holding covered funds on balance sheet; for this reason, they too would welcome a clearer definition that provides legal certainty. *See* Letter from Robert Toomey, Managing Director and Associate General Counsel, SIFMA, to the Office of the Comptroller of the Currency, at Annex A.II.B, dated Sept. 21, 2017, available at https://www.sifma.org/wp-content/uploads/2017/09/SIFMA-Response-to-OCC-Volcker-Rule-Request-for-Public-Input.pdf; Letter from Gregg Rozansky, Managing Director and Senior Associate General Counsel, The Clearing House Association L.L.C., to the Office of the Comptroller of the Currency, at Annex A-14, dated Sept. 21, 2017, available at https://www.theclearinghouse.org/advocacy/articles/2017/08/20170921-tch-comments-on-volcker-rule.

15 12 *C.F.R.* § 248.10(c)(1)(i)(B).

16 79 Fed. Reg. at 5678.

In many regions, retail funds are registered for sale and sold primarily or exclusively in jurisdictions other than those in which they are domiciled. A fund's domicile may be selected based on tax treatment, flexibility to distribute into multiple markets, investment restrictions, or a range of other factors, while distribution to retail investors is regulated consistent with the securities laws of the jurisdiction in which the fund is offered and distributed.[17]

Flexibility to distribute a fund in multiple jurisdictions is particularly desirable in smaller markets. For example, Hong Kong and Singapore do not permit funds domiciled in the other jurisdiction to be registered for sale, but both jurisdictions permit registration of Cayman-domiciled funds. For efficiency reasons, an asset manager may wish to domicile a single fund in Cayman and distribute in both jurisdictions, rather than launching duplicate funds. Investment optionality can also benefit investors. For example, Japanese retail investors frequently seek out Cayman-domiciled funds because they can provide strategies and characteristics not permitted in Japanese investment trusts, such as denomination in currencies other than Japanese Yen, and the ability to pay dividends from capital, as an income strategy.

To conform to the "home jurisdiction" requirement as we understand it, we have redomiciled some funds, at substantial expense, to the jurisdictions in which they are offered. In other instances, we have elected to treat funds (*e.g.*, funds organized under Cayman Islands law but registered and offered in Japan) as covered funds, eliminating our ability to use the "JPMorgan" name in their marketing, and requiring a custodian change to comply with the Rule's restrictions for covered funds on transactions with affiliates (the so-called "Super 23A" prohibitions). On a forward-looking basis, this approach to the "home jurisdiction" requirement has changed the way we make domicile determinations for new funds, and limits our options in creating cost-effective and efficient structures for our clients.

We believe the relevant question should be whether retail investors in the FPF are entitled to the protection of securities laws in the jurisdiction of the offering. For this reason, we recommend that the Agencies expressly clarify that the "home jurisdiction" of a FPF constitutes either the jurisdiction in which the issuer is organized, or any other jurisdiction in which ownership interests are offered or sold in a public offering. Although our preference is for this clarification to be included in a revised Rule, we believe it could be adequately addressed through interpretive guidance or in explanatory text accompanying a revised Rule.

"Predominantly Through One or More Public Offerings" Requirement

Another condition of the FPF exclusion is that a fund sell ownership interests "predominantly through one or more public offerings outside of the United States."[18] Although the Investment Company Act of 1940 imposes no similar requirement on RICs, which the Agencies categorically excluded from the definition of "covered fund," the Agencies explained their belief that "foreign

---

[17] In some cases it may be possible to obtain authorization for the sale of the fund to retail investors in the fund's domicile in order to conform to the "home jurisdiction" requirement; however, this approach may pose substantial costs with little reward, if those jurisdictions lack an appropriate retail market. In other cases, registration of the fund in the jurisdiction in which it is domiciled may be commercially impractical or result in adverse tax consequences.

[18] 12 *C.F.R.* § 248.10(c)(1)(i)(C).

funds that meet these requirements generally will be sufficiently similar to U.S. registered investment companies such that it is appropriate to exclude these foreign funds from the covered fund definition."[19] While this may be true, the condition results in the exclusion of funds that are sufficiently similar to RICs but may not meet this predominance test or, as important, cannot be *proven* to meet the test.

As a preliminary matter, we believe the rationale underlying this requirement reflects a mistaken understanding of the significance of privately placed investments in a registered fund. The Agencies stated that "a foreign fund authorized for sale to retail investors *that is also publicly offered* may, for example, provide greater information than funds that are sold through private offerings like funds that rely on section 3(c)(1) or 3(c)(7)."[20] We disagree. The extent and availability of information about a registered fund is primarily determined by whether it is authorized for public sale, and the requirements attendant to that authorization (*e.g.*, disclosure and registration requirements). These requirements remain applicable notwithstanding that the fund may also sell its interests to investors through a private placement. Indeed, the "predominantly through one or more public offerings" requirement could negatively impact retail investors in FPFs to the extent it limits investments in a FPF by non-retail investors or through means other than public offering, because investors lose the opportunity to further mutualize the fund's operating costs and otherwise benefit from economies of scale.

Additionally, monitoring compliance with this requirement presents substantial challenges. As noted above, JPMAM is heavily reliant on separately organized distributors for sales of our funds, limiting our ability to conclusively determine whether the fund reached retail investors. Our compliance efforts and costs for this component of the Rule, which are in part borne by investors, are substantial.

Finally, we understand from our affiliates and their trade organizations that, in the context of trading or making markets in foreign funds (including exchange-traded funds), particularly those funds with which a broker-dealer that is a banking entity has no relationship, it is challenging for the broker-dealer to determine with certainty whether the fund qualifies for the FPF exclusion. A broker-dealer can readily identify the registration status of the fund units or shares (*e.g.*, 144A vs. public offerings), but determining the predominant distribution method(s) of a particular fund's units or shares is much more complicated.[21] To the extent this requirement prevents broker-dealers from making efficient markets and providing liquidity, fund investors are further impacted.

For all of these reasons, we recommend that the Agencies revise this element of the FPF exclusion to require instead that a fund be authorized for sale to the public in one or more jurisdictions outside of the United States.

---

[19] 79 Fed. Reg. at 5678.

[20] 79 Fed. Reg. at 5678 (emphasis added).

[21] *See supra* note 14.

"Predominantly to Persons Other Than the Sponsoring Banking Entity, Issuer, Affiliates, Directors and Employees" Requirement

Finally, to qualify for the FPF exclusion a fund must be sold predominantly to persons other than the sponsoring banking entity, the issuer, and their affiliates, employees and directors.[22] The Agencies explained that this condition would be satisfied if interests sold to such persons constitute less than 15 percent of the fund.[23] For U.S. RICs, by contrast, a sponsoring banking entity and its affiliates are limited to less than 25 percent ownership of a fund, while no restriction is placed on directors or employees; indeed, employee investments are generally encouraged.[24] The Agencies explained that this provision is intended to limit the opportunity for a banking entity to evade the Rule by establishing a foreign public fund for the purposes of investing substantially in that fund;[25] however, they provided no rationale for this heightened risk of evasion in the context of non-U.S. funds.

As with the "public offerings" requirement, JPMAM's reliance on separately organized distributors limits our ability to conclusively identify our end investors, including employees and directors. Absent a more clearly articulated concern about evasion through FPFs, we recommend that the Agencies align this element of the FPF exclusion with the treatment for U.S. RICs, such that holdings by the banking entity and its affiliates must be less than 25 percent (as opposed to the current limit of 15 percent) of the fund after the permissible seeding; directors and employees should not be considered.

* * *

JPMAM appreciates the opportunity to provide these comments. We would be pleased to provide any further information or respond to any questions that the Board or the staff may have.

Very truly yours,

/s/ George C.W. Gatch

George C.W. Gatch

[22] 12 *C.F.R.* § 248.10(c)(1)(ii).

[23] *See* 79 Fed. Reg. at 5678.

[24] *See, e.g.*, SEC, Disclosure Regarding Portfolio Managers of Registered Management Investment Companies, 69 Fed. Reg. 52788, 52792 (Aug. 27, 2004) (observing that disclosure of a portfolio manager's ownership provides "a direct indication of his or her alignment with the interests of shareholders in that fund.").

[25] *See* 79 Fed. Reg. at 5678-79.