

Comment letter

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On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

13 February 2012

Attention of:

Department of the Treasury
Office of the Comptroller of the Currency
regs.comments@occ.treas.gov
OCC: Docket ID OCC-2011-14 and RIN: 1557-AD44

Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
Docket No. R-1432
RIN: 7100 AD 82

Federal Deposit Insurance Corporation
comments@fdic.gov
RIN: 3064-AD85

Securities and Exchange Commission
rule-comments@sec.gov
Release No. 34-65545; File No. S7-41-11
RIN: 3235-AL07

Public Comments to Notice of Proposed Rulemaking regarding Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (the Proposed Rule).

About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.



Ladies and Gentlemen:

We write on behalf of the European private equity industry's Public Affairs Executive (PAE), in response to the notice of proposed rulemaking of 7 November, concerning PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS, that would implement the requirements of section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (commonly known as the Volcker Rule).

The PAE is the voice of the European private equity and venture capital industry on policy matters of pan-European significance. The PAE is chaired by the chairman of the EVCA and its members include representatives from the venture capital, mid-market and large buyout constituents of the private equity industry; as well as institutional investors and representatives of national private equity and venture capital associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and the importance of those activities to the European economy.

The PAE sets out below the industry's high-level views concerning the parts of the proposed implementing rules that limit the ability of the private equity and venture capital industry, in the US and Europe, to receive funding from (a) US banking entities and (b) banking entities based outside the United States but with activities in the United States.

Impact of the Proposed Rules

Private equity and venture capital funds make illiquid, long-term investments into businesses - often early stage, fast growing or underperforming businesses - with the aims of helping those companies grow, improving their operations, and eventually realising a capital gain. As such, these funds provide a vital source of investment to businesses around the world - including in the United States. In 2010, the total amount invested from EU based PE funds in US companies was EUR 1.33billion in 168 companies.

The PAE is deeply concerned that the Volcker Rule and the proposed implementing rules will harm the potential for banking entities - including banking entities headquartered and operating primarily outside the United States - to diversify their asset bases so as to include long-term asset classes, such as private equity. In addition, the PAE is very concerned that these rules will act to diminish the amount of equity investments that can be employed in the real economy through private equity and venture capital funds. By limiting investment by banks and their affiliates in private equity and venture capital funds, the Volcker Rule and the implementing rules will limit the amount of capital available for investment by those funds in US and European businesses - investment that is sorely needed in the context of the current global economic situation.

Recommended Approach to Drafting the Final Implementing Rules

Obviously the Volcker Rule is now law and can not be modified to the degree that many European governmental authorities and financial institutions, including private equity and venture capital firms (such as those affiliated with banks), would like or would consider appropriate to mitigate the Volcker Rule's negative impact on private equity and venture capital investment. To the fullest extent permitted by the statutory language of the Volcker Rule, however, the PAE urges the responsible US regulatory agencies working to finalise the implementing rules to avoid an

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overbroad application of the Volcker Rule. The purpose of the Volcker Rule, as the PAE understands it, is not to limit the ability of the private equity and venture capital industry to raise and invest capital, but to promote the safety and soundness of banking entities. The Volcker Rule should be applied, therefore, only to the extent necessary to ensure the safety and soundness of the US banking system, while avoiding imposition of restrictions that unnecessarily impede private investment and economic growth.

The PAE further urges the responsible US regulators, as they finalise the proposed implementing rules, to act with due regard for the stated goal (set forth in the notice of proposed rulemaking) of limiting “the extraterritorial application of the statutory restrictions on covered fund activities and investment to foreign firms that, in the course of operating outside the United States, engage in activities permitted under relevant foreign law outside the United States, while preserving national treatment and competitive equality among U.S. and foreign firms within the United States”.

Indeed, the PAE urges the responsible regulators to recognise that there will be instances where private equity and venture capital funds utilise US exchanges or other US market infrastructure to carry out their businesses, even where these transactions have no economic consequences for these markets (e.g. investing in a business listed in the US which is based outside the US). We would echo the comments made by UK Chancellor Osborne that unless the implementing rules contain exceptions that are sufficiently broad to allow this behaviour, there is the risk that the Volcker Rule could disincentivise transactions with US counterparties, even where there would be no risk to the safety and soundness of the banking system or to the US economy or financial system.

Extraterritorial Application

Under the proposed rules, the Volcker Rule would have unprecedented extraterritorial application. At a minimum, the rules implementing the Volcker Rule should not prohibit a non-US banking entity from investing in a non-US fund - even if that fund is offered for sale or sold to a resident of the US - so long as the non-US banking entity does not participate in the US offering. Non-US banks are already regulated in their home country; in the EU we have strict solvency requirements under the Capital Adequacy Directives which cover these concerns. Therefore, the PAE strongly objects to any further regulation imposed on EU banks. An excessively broad extraterritorial application runs the real risk of disrupting international fund flows, reducing the pool of available equity investments globally.

We are also concerned about the implications of “Super 23A”, which would restrict a bank from lending or otherwise extending credit to, or entering into other covered transactions with, a covered fund the bank manages, advises or sponsors, even if both the bank and the fund are completely outside of the US. In all circumstances non-US banks should be able to provide Super 123A credit to non-US permitted funds.

US Marketing Restriction (restriction on investment by non-US banks in funds with US investors)

As noted above, the PAE is concerned about the extraordinary extraterritorial application of the Volcker Rule and the implementing rules. The PAE recommends that a non-US banking entity should be permitted to invest in funds that were sponsored and marketed by third parties, even if such funds have US investors, so long as the banking entity and its affiliates and employees are not involved in the US marketing.

The US marketing restriction also raises a timing issue: non-US banks should be permitted to invest in funds that the bank itself, or third parties, have marketed/sold to US investors in the past, so long as the marketing and sales to US investors end by the end of the conformance period (July 2014, at the earliest).

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The PAE also believes that the implementing rules should clarify that non-US banking entities may market funds (through their affiliates and employees in the US, if any, as well as affiliates and employees outside the US) to US investors so long as the fund whose ownership interests are being marketed is organised outside the United States and is managed by the non-US banking entity or by a non-US private equity or venture capital firm headquartered or whose principal operations are outside the United States.

In all these cases the current draft rule has a negative impact on US and European investors and runs the risk of US investors being barred from many European funds.

Definition of covered funds

Private equity and venture capital funds are long term investors. Therefore, we believe it is a mistake to treat the private equity and venture capital industry under the same rules as hedge funds and to increase by such rules the cost for banks investing via private equity and venture capital funds into the real economy. This will make fund raising and therefore private equity and venture capital investments more difficult at a time where the economy and notably SMEs desperately need access to capital. Therefore we ask that private equity and venture capital funds(i.e. closed ended funds which are not leveraged, with no redemption right and investing into unlisted companies), not to be subject to the proposed rules.

Parity of Non-US Funds with US Funds

To the extent US funds are not treated as “covered funds”, similar Non-US funds should also not be treated as “covered funds”. Regarding the proposed exemption for regulated funds, it should be noted that the EU’s AIFM Directive will lead to EU-fund managers (and indirectly their funds) to become regulated.

Endorsement of the Views of the PEGCC and the NVCA

We note that both the Private Equity Growth Capital Council (PEGCC) and the US National Venture Capital Association (NVCA) have submitted responses both to the notice of proposed rulemaking of 7 November and to earlier requests for public comments in connection with the Volcker Rule study and the development of the proposed rules implementing the Volcker Rules.

We fully endorse the views expressed by the PEGCC and we are gratified, for example, that the proposed implementing rules generally permit investment in private equity and venture capital funds (a) by non-US banks having operations in the US so long as those funds are offered only to non-US persons, (b) by bank “customer funds” and (c) by bank-sponsored retirement schemes and bank employees.

However, the PAE believes that the proposed rules could provide additional flexibility to banking entities wishing to invest in private equity and venture capital funds without compromising the goals of the Volcker Rule as we understand them. We urge the responsible US regulators to clarify certain ambiguities that still exist, as recommended in the PEGCC’s and NVCA’s recent comment letters.

In particular, in view of the concerns noted above regarding the extraterritorial application of the Volcker Rule and the implementing rules, the PAE recommends that the implementing rules relating to Bank Holding Company Act Section 13(d)(d)(1)(l) provide as much flexibility as possible, consistent with the relevant statutory language, to non-US banking entities and non-US private equity and venture capital firms - including as suggested above under the heading “Extraterritorial Application”. In addition, if the restriction on offering fund interests is deemed to apply to third parties (and not only to non-US banking entities and their employees),, the rules should make clear

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that non-US banking entities may invest (through parallel vehicles) alongside private equity and venture capital funds managed and offered by US and non-US private equity and venture capital firms.

In addition, the PAE believes that the proposed rules should provide unambiguous guidance that insurance businesses may make general and separate account investments in private equity and venture capital funds. We encourage the regulators to provide this guidance, because insurance firms are already subject to extensive regulation by the states of the United States and by European and other regulators, and because we believe that the text of the Volcker Rule supports permitting such investment by insurance businesses.

Extension of the Conformance Period

Although we understand that rules concerning the Volcker Rule's conformance period were published early last year, the PAE urges the US Federal Reserve Board and any other responsible regulators to grant banking entities -- at least with respect to interests in private equity and venture capital funds whose interests are not freely tradeable and that do not provide for redemption in (as opposed to withdrawal rights due to illegality, for example) in the ordinary course (PE fund interests)--as much time as necessary to allow banking entities to come into conformance with the Volcker Rule and the implementing rules without depressing prices in the very thin and limited secondary market for PE fund interests. For example, the regulators could agree that one or more of the available three one-year extensions of the conformance periods will be automatically granted upon written request by a banking entity so long as the banking entity can show that it has made reasonable good faith efforts to sell any PE fund interests that it holds at a price at least equal to their value at that time as determined by the banking entity.

The PAE appreciates the opportunity to offer comment on the notice of proposed rulemaking, and would be ready and able to offer any further support or answer further questions on the proposed implementing rule or and on the European private equity and venture capital industry in general, if the responsible regulatory agencies would find this helpful.

Yours respectfully,



Karsten Langer

EVCA Chairman

About EVCA

The European Private Equity and Venture Capital Association is the voice of European private equity and venture capital, representing more than 1,300 members. In addition to promoting the industry among key stakeholders, such as institutional investors, entrepreneurs and employee representatives, EVCA develops professional standards, research reports and holds professional training and networking events.