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February 13, 2012

Via Electronic Mail

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219
Docket ID OCC-2011-14

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN: 3064-AD85

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1432
RIN: 7100 AD 82

David A. Stawick, Secretary
Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
RIN: 3038-AD05

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
File No. S7-41-11

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

Ladies and Gentlemen:

General Electric Company ("GE") and General Electric Capital Corporation ("GECC")[1] appreciate the opportunity to comment on the proposed rule (the "Proposed Rule") included in the notice of proposed rulemaking (the "NPR")[2] issued on November 7, 2011, by the Office of

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1 GE and GECC are savings and loan holding companies that are prudentially supervised by the Federal Reserve.

2 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (proposed Nov. 7, 2011) (to be codified at 12 C.F.R. pt. 248).

the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC") and the Securities and Exchange Commission (the "SEC") and the notice of proposed rulemaking issued on January 11, 2012, by the Commodity Futures Trading Commission (the "CFTC" and together with the OCC, the Federal Reserve, the FDIC and the SEC, the "Agencies"), in order to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), commonly referred to as the "Volcker Rule."[3]

We write to raise concerns about significant unintended and adverse consequences that will result if the Proposed Rule is adopted as proposed. Our comments are not intended in any way to undermine the objectives identified by Congress in enacting the Volcker Rule. We acknowledge that the nature of the prohibitions contained in the Volcker Rule, coupled with the way in which the statutory exceptions to those prohibitions were crafted, made the task of drafting and implementing regulations challenging. Although we appreciate the Agencies' efforts to strike the correct balance in the Proposed Rule, we are concerned that the sweeping effects of the Proposed Rule and the narrowness of the exceptions to it would have a substantial and negative impact not only on banks and the broader financial services industry, but also on industrial and other non-financial businesses, and ultimately the real economy. A wide range of businesses and market participants should be concerned about the potential effects of the Proposed Rule.

The Volcker Rule prohibits U.S. depository institutions and certain of their affiliates from engaging in proprietary trading and investing in hedge funds or private equity funds in order to limit risk to those institutions. In its current form, however, the Proposed Rule prohibits many activities and covers many entities that were not intended to be prohibited or covered. This overbreadth results in a set of complex and inflexible restrictions that defeat the very purpose of the Volcker Rule, which fundamentally is risk reduction. Instead, the Proposed Rule could unintentionally have the opposite effect: increasing risk, misallocating compliance burdens to non-financial companies, destabilizing firms, and harming the real economy. Significant adjustments in the final rule are essential to avoid these consequences.

Below is a summary of critical issues that we have identified as arising from the Proposed Rule. An appendix to this letter contains further detail and some specific proposed solutions for the Agencies' consideration.

I. Overbreadth of the term "banking entity"

The Volcker Rule applies to all "banking entities", which are defined as U.S. insured depository institutions, all companies that control them, and all affiliates and subsidiaries of those companies. The Proposed Rule adopts the very broad definitions of "affiliate" and "subsidiary" from the Bank Holding Company Act of 1956 (the "BHC Act"), and therefore would apply to firms in which a banking entity owns 25% or more of a class of voting securities,

[3] The Volcker Rule is incorporated as a new Section 13 of the Bank Holding Company Act of 1956 (12 U.S.C. § 1851). References in this letter to the Volcker Rule are to Section 619 of Dodd-Frank, not to the Proposed Rule implementing Section 619.

or even as low as 5% of a class of securities if there are other sufficient indicia of control. For non-bank firms that control depository institutions, such as grandfathered savings and loan holding companies ("SLHCs") or firms that own industrial loan companies, this standard captures a staggering number of companies and enterprises that we believe were not the types of entities Congress was concerned about in adopting the Volcker Rule. These entities include, among others:

- Non-financial commercial firms held in the corporate chain of the banking entity;
- Companies in which the banking entity holds a minority investment that does not constitute actual "control" in the common sense of the word; and
- Foreign firms in which the banking entity holds a significant investment, including financial firms regulated by foreign supervisors.

The BHC Act definitions of "affiliate" and "subsidiary" may make sense in some banking law contexts where the concern is outside firms having influence on a U.S. bank. But here, the use of such broad definitions creates a vast array of affiliates covered by the Volcker Rule, all of which would be subject to prohibitions that were not meant for non-financial firms. The result may be that potentially thousands of affiliates of GECC that engage primarily or exclusively in non-financial activities (such as those that operate primarily in the industrial, technological, manufacturing or healthcare businesses) will be subject to the Volcker Rule's prohibitions. They appear to be required to implement extensive compliance programs geared for risks that they do not incur, and they may need to restructure or divest certain assets to comply with the Volcker Rule because of the unintentional consequences of the covered fund prohibitions of the Proposed Rule. This cannot be the outcome the Volcker Rule was intended to achieve.

We appreciate the Agencies' efforts to deal with these concerns in limited but important circumstances. For example, we support the Agencies' clarification in the NPR that the prohibitions of the Volcker Rule would not apply to qualified pension plans where the banking entity acts in a fiduciary capacity, not as principal investor. We believe, however, that it is vital to do more. The Federal Reserve has made clear that in some circumstances it considers a more limited scope of the term "affiliate" to be appropriate in order to avoid unintended or contradictory results (*e.g.*, in the proposed regulations for Sections 165 and 166 of Dodd-Frank). The same logic applies to the Volcker Rule.

II. Overbreadth of the covered fund prohibitions

The Proposed Rule defines private equity funds and hedge funds (collectively "covered funds") as any entity that would be an investment company under the Investment Company Act of 1940 (the "1940 Act") but for exceptions in sections 3(c)(1) and 3(c)(7) thereof. Although it is true that this definition describes actual private equity and hedge funds, it also captures numerous other corporate structures that are common within financial and non-financial firms that may be banking entities. The statute provides the Agencies with the authority to tailor the fund definition to avoid overbreadth, and the legislative history specifically contemplates that the

Agencies will do so. Examples of the types of structures that can inadvertently fall under the covered fund definition include, among others:

- Certain wholly owned subsidiaries;
- Certain joint ventures;
- Government-sponsored programs to promote public welfare and investment;
- Funding vehicles;
- Securitization vehicles; and
- Foreign funds.

The Proposed Rule acknowledges the overbreadth of the covered fund definition, and it addresses most of these examples to a limited extent. However, the Proposed Rule fails in two ways to address the problem of overbreadth. First, the Proposed Rule attempts to carve out only a small subset of the affected entities, such as wholly owned subsidiaries used for liquidity management purposes, joint ventures that are "operating companies", and securitization vehicles that meet a very narrow set of criteria. We appreciate that the Agencies made this effort to resolve some of the unintended consequences of the broad definition of covered fund, but this group of carved-out entities only scratches the surface of the problem. We think the Agencies should go much further to solve the problems with the covered fund definition. For example, wholly owned subsidiaries with no outside equity investors cannot in any way be seen as pooled investment vehicles or funds, and the Volcker Rule prohibitions on fund investing and proprietary trading apply to them directly. Thus, there is no reason to include wholly owned subsidiaries within the scope of covered funds.

Second, the Proposed Rule uses the exception for safety and soundness purposes contained in Section 13(d)(1)(J) to carve out these entities, rather than using the Agencies' authority to clarify the meaning of the statutory term "covered fund" by excluding the entities from the definition of that term. As a result, the Volcker Rule provision known as "Super Section 23A," which limits the transactions that may occur between a covered fund and the banking entity, continues to apply to these carved-out entities. Consequently, the Proposed Rule essentially allows a firm to own these excepted entities, but renders many of them useless because they may no longer conduct their ordinary businesses through transactions with the banking entity. The Agencies should use their discretion to carve these entities out of the definition of covered funds, thereby avoiding these disruptive consequences.

III. Unintended consequences of the proprietary trading prohibitions

The prohibition on proprietary trading under the Proposed Rule attempts the difficult task of sorting out trading activity that is "proprietary" from trading activity that is for a permitted purpose such as hedging, market making or underwriting. Although we appreciate the Agencies' efforts to strike an appropriate balance, we have identified a number of areas where the Proposed

Rule would cut too broadly, and is likely to hinder the activities of a banking entity that were not meant to be prohibited.

- The Proposed Rule could result in U.S. businesses being restricted from or denied access to the capital markets because market makers may pull back from their normal activities as a result of the uncertainty around permitted market making activities and proprietary trading, resulting in reduced liquidity and increased cost for issuers.

- The limited exclusion from the proprietary trading prohibitions of the Proposed Rule for liquidity management would restrict banking entities from operating cost-effective liquidity management programs that plan for both short- and long-term needs.

- The exception from the Proposed Rule for hedging activities does not clearly articulate that hedging activities will be treated by the Agencies on an enterprise-wide basis.

- The Proposed Rule does not define how the thresholds for the expanded quantitative reporting and recordkeeping requirements would apply to a grandfathered SLHC or a holding company of an industrial bank.

- The Proposed Rule may unintentionally interfere with the normal business activities of banking entities that own power and natural gas assets used in connection with the bulk electric system or the sale of natural gas under the jurisdiction of the Federal Energy Regulatory Commission.

In the appendix to this letter, we offer concrete solutions to these issues that will avoid unnecessary limitations or burdens on traditional financial activity.

IV. Broad economic impacts

The unintended consequences described above are already having a significant effect on banking entities that are planning their compliance with the Proposed Rule. For example, transactions that would involve traditional lending or internal financial management—and having nothing to do with hedge funds or private equity funds—would often be conducted through entities that are caught by the overbroad defined term "covered fund". Such transactions must be scrutinized, and possibly delayed or cancelled due to the uncertainty regarding whether the entity will ultimately be deemed a covered fund by the Agencies. If the Proposed Rule becomes effective in its current form, the requirement to divest these entities during the statutory conformance period will only increase the disruption to banking entities and likely increase risk rather than abating it.

Furthermore, these unintended consequences are amplified when they are applied to non-financial holdings and affiliates of banking entities. Congress did not intend to inhibit this broad array of structures that are used to organize firms' permissible holdings, and Congress certainly

did not intend to inflict this burden on non-financial firms. The resulting impact on the economy will be significant. Banking entities will have to conduct reviews of every one of their potentially thousands of controlled companies and probably all of their joint ventures to determine which of them fall within the definition of a covered fund. Under the Proposed Rule, such reviews would be extremely costly because they would be ongoing and will require a complex analysis under the 1940 Act. Companies will likely refrain from engaging in some transactions or activities that are not clearly permissible under the Proposed Rule, but which were not meant to be prohibited by Congress, creating a chilling effect on the economy generally.

V. Conformance period concerns

The Proposed Rule incorporates the final conformance period rules issued by the Federal Reserve under Section 13(c) of the BHC Act on February 8, 2011. The conformance rules are not formally part of the Proposed Rule. Nonetheless, in the NPR, the Federal Reserve requests comments on the conformance provisions.

First, there is significant uncertainty about whether the various extensions of the conformance period will be readily available. Dodd-Frank provided a two-year period for companies covered by the Volcker Rule to conform their activities and divest ownership interests in covered funds, plus the opportunity for additional extensions of time if needed. Although a banking entity may be actively working to divest a covered fund, market conditions, the contractual terms governing the banking entity's investment, or other factors could prevent the banking entity from divesting the fund quickly and in a way that limits the potential losses the banking entity may incur. In adopting the Volcker Rule, Congress intended to limit unnecessary risk taking that may result in losses. If there is uncertainty surrounding the availability of the conformance period extensions, then banking entities will be forced to dispose of potentially valuable assets at discounted prices. Such a fire sale will, paradoxically, all but guarantee that there will be losses. The Agencies should provide clarity about when extensions of the conformance period will be available sufficiently in advance of any such extensions that banking entities may make informed decisions about divestitures.

Second, although GE and GECC are strongly committed to a culture of compliance generally and to compliance with the Volcker Rule specifically, we are very concerned about the timing of the compliance program requirements contemplated by the Proposed Rule, which requires banking entities to have compliance programs developed and implemented by the Volcker Rule's effective date of July 21, 2012. Although the statute provided for a two-year conformance period for the activities and investments of banking entities, the Proposed Rule does not provide *any* conformance period for banking entities to build their compliance program during this two-year period. The formation and adoption of the compliance programs required by the Proposed Rule will necessarily be a complex process. The complexity and cost will unnecessarily increase if the July 2012 deadline is maintained. Banking entities would have to build compliance programs on the basis of the Proposed Rule and then make last minute changes, potentially of enormous significance. The problem is compounded by the fact that the Proposed Rule explicitly requires a banking entity to have the compliance program in place

before it can avail itself of a number of exceptions to the proprietary trading prohibition and the hedging exception to the prohibition on ownership interests in covered funds.

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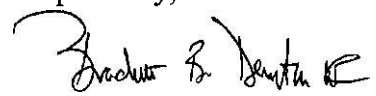
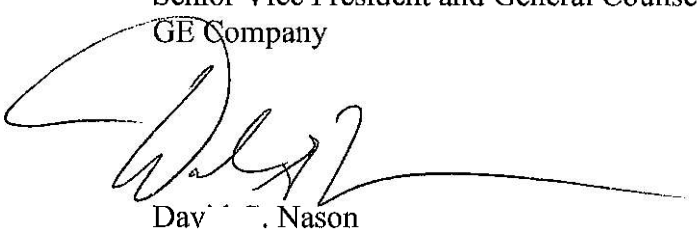
As we hope we were able to convey in this letter, we are very concerned about the manner in which the Volcker Rule will be implemented. In our view, the unintended consequences resulting from the Proposed Rule pose genuine risks to the markets and the economy generally, and to the ability of many financial and non-financial companies to conduct their legitimate business activities specifically. Our concerns are set forth in more detail in the attached appendix. We appreciate that the Agencies are taking the time to consider our comments and we would be pleased to discuss them with the staff of the Agencies in more detail. If there are any questions, please feel free to contact the undersigned at the number provided below.

Respectfully,



Brackett B. Denniston III
Senior Vice President and General Counsel
GE Company



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Appendix[1]

I. Overbreadth of the term "Banking Entity"

The Volcker Rule applies to all "banking entities". The scope of this term is therefore crucial because it determines which entities are subject to the prohibition on proprietary trading, the restrictions on certain investments in and relationships with covered funds, and the requirements for implementing a compliance program.

A. The Proposed Rule applies the Volcker Rule to a wide range of entities, including non-financial companies, and creates uncertainty about which entities are subject to the Rule

The Proposed Rule defines "banking entity" very broadly to include not only insured depository institutions themselves, but also all companies that control them and any "affiliates" or "subsidiaries" of those companies. The definitions of "affiliate" and "subsidiary" are derived from the BHC Act. The breadth of the BHC Act's definitions of these terms may be appropriate in the context of general bank regulation, but it creates significant problems when the consequence entails severe prohibitions and potential unintended consequences. The Agencies have acknowledged that the scope of the terms "affiliate" and "subsidiary" is quite broad.[2] The meaning of these terms depends upon the BHC Act definition of "control" of a company, which includes three triggers: (1) the ownership or control of 25% or more of any class of voting securities of the company, (2) controlling in any manner the election of a majority of the board of directors or similar body of the company or (3) having a controlling influence over the management or policies of the company, but only if the Federal Reserve determines after notice and an opportunity for a hearing that such a controlling influence exists.[3] The Financial Stability Oversight Council (the "FSOC") also recognized the inherent breadth of the definitions when it cautioned that the Agencies should implement the terms in a manner that avoids results clearly not intended by Congress when it enacted the Volcker Rule.[4] [5]

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1 Capitalized terms used but not defined herein have the meanings attributed to them in the body of our comment letter.

2 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846, 68,855 (proposed Nov. 7, 2011) (to be codified at 12 C.F.R. pt. 248) [hereinafter Proposing Release].

3 12 U.S.C. § 1841(a).

4 FINANCIAL STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS 68-69 (2011) [hereinafter FSOC STUDY].

5 For example, we support the Agencies' decision to confirm that pension plans are not subject to the Volcker Rule, thereby resolving one of the concerns about unintended consequences referenced in the FSOC study. *Id.* at 61-62. Pension plans are tightly regulated under ERISA, including with respect to their investments and their relationships with affiliates. If pension plans

In particular, the third, "controlling influence" prong of the definition of "control" is a highly subjective determination that depends heavily on the facts and circumstances of the relationship in question. As a result, it creates uncertainty about which entities will be deemed to be banking entities subject to the Volcker Rule because of an attenuated relationship to a depository institution. If this prong is part of the definition for purposes of the Volcker Rule, banking entities will be required to review a much broader range of investments and relationships in or with potential "affiliates" or "subsidiaries" than would be required under the other, objective, tests. Due to the facts and circumstances nature of the test, this would be a very granular and burdensome review. Moreover, because of the inherent uncertainty involved in the test, and the Federal Reserve's broad interpretation of the controlling influence test, banking entities would frequently find it necessary to operate based on Federal Reserve guidance regarding whether entities are "controlled", unless a non-control determination is obtained from their regulator. The need for such determinations would also create an enormous burden on the Agencies, presumably the Federal Reserve in particular.

Moreover, without further clarification from the Agencies in the final rules, the unintended result of the use of the BHC Act definitions of "affiliate" and "subsidiary" may be that potentially thousands of affiliates of GECC that engage primarily or exclusively in non-financial activities (such as those that operate primarily in the industrial, technological or manufacturing businesses) will be subject to the Volcker Rule's prohibitions. The same will be true for the affiliates of other companies that are subject to the Volcker Rule because they control an industrial bank or a savings association. Many of these companies are not engaged in the types of businesses that Congress had intended to restrict through the Volcker Rule, yet under the Proposed Rule these companies will nonetheless be required to implement extensive compliance programs and may need to restructure or divest certain assets to comply with the Volcker Rule. The definition of banking entity is broader than is necessary to achieve the aims of Congress in passing Dodd-Frank.

One unintended consequence would be that a non-banking business would need to consider the practical impact of allowing an unaffiliated banking entity to make an investment in the non-banking business or one of its subsidiaries. For example, an investment by a banking entity in 25% of a class of voting stock of an unaffiliated company would cause that unaffiliated company (in any industry) to become a banking entity itself and therefore subject to the Volcker Rule. Even an investment of as little as 5% of the voting stock could produce such a result if the terms of the investment and other relationships between the companies were such that the applicable banking regulator would deem the previously unaffiliated company to be "controlled" by the investing banking entity for purposes of the BHC Act. This unintended consequence may chill investment, stunt innovation, and have a negative general impact on the growth of emerging technologies and industries.

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were covered under the Volcker Rule. there could be significant negative effects on pension plans, the way they are managed and their investments, including possible conflicts with ERISA.

The Agencies recognized in the NPR that internal inconsistencies and potentially unintended consequences could arise from the fact that a legal entity may be both a banking entity and a covered fund.[6] Some limited steps were taken to address this concern, but they do not solve all of the resulting problems. For example, the Proposed Rule excludes from the definition of banking entity those covered funds organized and offered under Section __.11 of the Proposed Rule. This is clearly appropriate, because without such an exception such permissible funds could not conduct the very activities that they were established to conduct. By contrast, other covered funds that a banking entity may hold pursuant to another exception (such as the exceptions for hedging or for covered funds acquired in satisfaction of a debt previously contracted), and funds that are not captured by the definition of "covered fund," will not get the benefit of this exclusion. Some of these funds pose little or no risk of evasion of the Volcker Rule requirements due to the nature of their businesses, and others would have their normal activities restricted by the prohibitions of the Volcker Rule if not otherwise excluded from the definition of "banking entity" even though the Agencies have acknowledged that their activities should be permissible (such as funds that operate pursuant to the public welfare exception under Section 13(d)(1)(E) of the BHC Act or the safety, soundness and financial stability exception under Section 13(d)(1)(J) of the BHC Act). The Agencies appear to have recognized this issue because the NPR states generally that the term "banking entity" does not include any affiliate or subsidiary of a banking entity, if that affiliate or subsidiary is a covered fund or an entity controlled by such covered fund.[7] However, the Proposed Rule only makes this explicit for those covered funds organized and offered under Section __.11 of the Proposed Rule.

B. Suggested changes to the definition of "banking entity"

(i) Drop the controlling influence test and elevate the objective control standards: The Agencies should, at a minimum, define the terms "subsidiary" and "control" without any subjective test, such as the "controlling influence" test. An objective approach would resolve a substantial amount of the uncertainty surrounding the subjective application of the controlling influence test explained above. In addition, it would minimize the need to approach the Federal Reserve or the other Agencies for determinations of control or non-control, thus reducing the regulatory burden.

There is precedent for this request. The Federal Reserve has previously made clear that in some circumstances it considers a more objective approach to the concept of "control" to be appropriate. In the proposed regulations implementing the single-counterparty credit limits in Sections 165 and 166 of Dodd-Frank,

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6 Proposing Release, *supra* note 2, at 68,855.

7 *Id.*

the Federal Reserve also dropped the "controlling influence" test in favor of more objective definitions, reasoning that "a simpler, more objective definition of control is more consistent with the objectives of single-counterparty credit limits".[8] The same logic applies here.

In addition, for purposes of the Volcker Rule, the objective standards should be elevated to a level of control that provides actual control of the entity. We believe that a greater than 50% voting interest or consolidation for accounting purposes would be appropriate.

(ii) Exclude certain non-financial affiliates: The Agencies should also consider excluding from the definition of "banking entity" any affiliate of a banking entity that is not principally engaged in activities that are financial in nature or incidental to a financial activity, as well as any affiliate that is part of a chain of affiliates that are not principally engaged in activities that are financial in nature or incidental to a financial activity. Such an approach in the final rules would help reduce the unintended consequences of the definition of "banking entity", which the FSOC recommended that the Agencies carefully consider.[9] The Volcker Rule does not appear to be aimed at a range of companies that engage mainly in industrial, technological, manufacturing and other non-financial activities. This concept is supported by other parts of Dodd-Frank that distinguish between the regulation of financial and non-financial activities. For example, Title I of Dodd-Frank allows a non-bank financial company, under certain circumstances, to establish an intermediate holding company for its financial activities in order to limit consolidated supervision by the Federal Reserve to the company's financial activities. Non-financial activities would be conducted outside the intermediate holding company. The same logic should apply to the Volcker Rule, particularly where the consequences of looking beyond an intermediate holding company are not just prudential supervision of non-financial activity, but outright prohibitions that were not intended to apply to non-financial companies.

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8 Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 614 (Jan. 5, 2012).

9 FSOC STUDY, *supra* note 4, at 68-69 ("The Council recommends that the Agencies carefully consider the impact of certain BHC Act definitions on the Volcker Rule's definition of 'banking entity' and implement that term in a way that avoids results that Congress clearly did not intend in enacting the Volcker Rule.").

(iii) Exclude "affiliates" controlled by third parties: The Agencies should also exclude from the definition of "banking entity" those affiliates of a banking entity that are primarily "controlled" by an unaffiliated third party that is not a banking entity. For example, GECC might own 25% of the voting stock of a company, but if a third party that is not a banking entity owns the remaining 75%, then including the company in question as an affiliate of GECC would potentially subject the company to the prohibitions of the Volcker Rule. Excluding such companies from the definition of "banking entity" would help alleviate the concern that non-banking businesses would be dissuaded from seeking investment from banking entities.

(iv) Exclude other permissible funds: The Agencies should provide additional exceptions from the definition of "banking entity" for covered funds that are determined by rule to be permissible. The exclusion for covered funds organized and offered under Section __.11 of the Proposed Rule should be expanded to exclude any covered funds that are permissibly held pursuant to any other exception of the Volcker Rule or the final regulations (including any exceptions pursuant to Section 13(d)(1) of the BHC Act).

(v) Exclude certain non-U.S. "affiliates": Finally, in the event the Agencies do not implement the recommendation at the end of Part I.B.(i). above, the Agencies should at least exclude from the definition of banking entity those non-U.S. affiliates that are neither (A) majority-owned by a U.S. banking entity nor (B) consolidated by a U.S. banking entity for accounting purposes, because of the exceptional practical challenges of imposing the prohibitions of the Volcker Rule on foreign joint ventures that are primarily controlled by a non-U.S. entity. Non-U.S. affiliates would include at least those whose principal place of business is outside the United States. This approach will minimize the potential for conflict with overseas regulators, and is particularly important where a foreign joint venture is prudentially regulated to avoid an overbroad extra-territorial effect of the Volcker Rule.

C. The Proposed Rule requires a very broad range of affiliates to implement compliance programs

In addition to the negative prohibitions on covered funds, the Proposed Rule would impose a compliance burden on a wide range of entities, including all entities that are deemed "affiliates" of a banking entity for BHC Act purposes, despite the fact that in certain cases a banking entity may not have sufficient actual control over a deemed affiliate to require it to implement and adhere to a compliance program. The broad

application of the compliance program requirement also discourages joint venturers and other entities that are seeking investors from looking to any banking entity or any of its affiliates for investment, because it would cause such entities to become banking entities themselves.

The Agencies should adopt a bright-line ownership test below which an affiliate of a banking entity is not subject to the compliance program requirement. We believe the appropriate threshold is 50% of the equity or less, because ownership above 50% should be sufficient for a banking entity to implement unilaterally a compliance program for such affiliate. Of course, the anti-evasion provisions of the Volcker Rule would still prohibit a banking entity from using such affiliates to avoid the prohibitions on proprietary trading and holding ownership interests in, and having certain relationships with, hedge funds and private equity funds.

Section __.20 of the Proposed Rule uses the term "reasonably designed" in more than one instance to refer to the objectives of the required compliance program. We agree with the use of this standard, which allows enough flexibility to address the problem with the broad nature of the definition of "affiliate". It would be unreasonable to require the same compliance program for affiliates where the equity ownership is below a certain threshold.

When the affiliate in question does not engage substantially in the types of activities Congress intended to address when it adopted the Volcker Rule (namely, prohibited proprietary trading and covered fund activities), then banking entities should have more discretion. Banking entities should have the ability to perform their own risk assessment after having the opportunity to consider the nature of an affiliate's activities. The banking entity should then be obligated to implement a compliance program that extends to the affiliate in question only if it concludes that the program would be warranted. It would not be logical to require GE, for example, to implement compliance programs designed to restrict proprietary trading and investments in hedge funds or private equity funds at an industrial affiliate that manufactures machinery, but does not engage in any conduct prohibited by the Volcker Rule.

II. Overbreadth of the covered fund prohibitions

A. The Volcker Rule should not prohibit firms from structuring their legitimate financial activities using common corporate structures such as wholly owned subsidiaries and joint ventures[10]

Although we appreciate the Agencies' efforts to provide exceptions from the definition of "covered fund" for certain types of corporate structures under Section 13(d)(1)(J) of the BHC Act, the limited exceptions provided in Section __.14 of the Proposed Rule for wholly owned liquidity management companies, acquisition vehicles and certain joint ventures are far too narrow and restrict many common activities and entities that the Volcker Rule was not intended to capture. In a colloquy that is an important part of the legislative record, Representative Barney Frank, the co-sponsor of Dodd-Frank and the Chair of the House Financial Services Committee, and Representative Jim Himes clarified that the Volcker Rule was not intended to disrupt firms' ownership or control of "subsidiaries or joint ventures that are used to hold other investments, [and] that the Volcker Rule won't deem those things to be private equity or hedge funds and disrupt the way the firms structure their normal investment holdings."[11] Chairman Frank went on to explain that "[w]e do not want these overdone. We don't want there to be excessive regulation … and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure that they do."[12]

It is clear that Congress expected that the Agencies would exempt any subsidiary or joint venture used to structure firms' "normal investment holdings". Wholly owned subsidiaries, for example, have no outside equity investors that are owners and thus cannot be hedge funds or private equity funds in any conventional or logical sense. If a banking entity is permitted to engage in an activity directly, the fact that the banking entity elects to establish a wholly owned subsidiary or enter into a joint venture to perform the same function should not result in the ownership of the subsidiary or joint venture being prohibited. Yet this can often be the result under the Proposed Rule, because so many subsidiaries could fall within the definition of "investment company" under the 1940 Act but for the Section 3(c)(1) or 3(c)(7) exception.[13] In the case of a

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10 When this appendix refers to subsidiaries and joint ventures, it should be understood to refer not only to well-established forms of legal organization in the U.S., such as corporations, partnerships and limited liability companies, but also to similarly purposed structures that are legally organized in other less common ways, such as trusts and forms of organization used in non-U.S. jurisdictions.

11 111 CONG. REC. H5226 (daily ed. June 30, 2010).

12 *Id.*

13 For example, a minority investment in another company (whether or not controlling for purposes of the BHC Act) that is a permissible investment by a banking entity would become impermissible if it were held through a wholly owned special-purpose subsidiary, because the subsidiary would own nothing but "investment securities". The definition of "investment company" includes any company more than 40% of whose assets are investment securities. Investment Company Act of

wholly owned subsidiary, such a result would be form over substance and would conflict with the stated intent of the Volcker Rule. Yet without further relief from the Agencies, that is precisely what might occur as a result of the failure to adopt the clarifications to the statutory definition of "hedge fund" and "private equity fund" that Congress intended and expected.

Defining the terms "hedge fund" and "private equity fund" has historically been a difficult task. In adopting the Volcker Rule, Congress relied on an imperfect definition by importing concepts from the 1940 Act,[14] with the hope and expectation (demonstrated in Mr. Frank's statement quoted above, referring to avoiding the disruption of firms' normal investment structures, that "the regulators will appreciate that distinction") that the Agencies would correct any shortcomings, including the over-inclusive nature of the definitions, during the rulemaking process. The 1940 Act and the related rules were developed with some particular goals in mind—goals that differ significantly from those of the Volcker Rule. One of the primary purposes of the 1940 Act was protecting retail investors that were investing their savings in pooled investment vehicles.[15] As a result, the 1940 Act takes a very broad approach to the definition of "investment company" and applies a comprehensive regime of substantive regulation to those vehicles. That broad sweep and that substantive regulatory regime covered a number of entities that Congress did not intend to regulate in connection with the 1940 Act. This, in turn, necessitated broad statutory exceptions from the broad definition of "investment company". As a result, a very large number of entities that would never be thought of as pooled investment vehicles—much less as "hedge funds" or "private equity funds"—must rely

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1940 § 3(a)(1)(C), 15 U.S.C. § 80a-3 (2011). This is discussed later in this section of the appendix.

14 We acknowledge that the SEC, too, has defined hedge funds and private equity funds by reference to Sections 3(c)(1) and 3(c)(7) in recent rulemakings under the Investment Advisers Act of 1940, one of which was vacated by the DC Circuit on other grounds. Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006); Investment Advisers Act Rule 203(b)(3)-1 (17 C.F.R. § 275.203(b)(3)-1 (2011)); SEC Form ADV. In those situations, however, the context was limited to the registration requirements applicable to entities that provide investment advice to such an entity. A Section 3(c)(1) or (7) entity that uses the services of an investment adviser is far more likely to fit within the conventional understanding of the term "private fund" than is an unadvised entity. In this manner, the SEC's reliance upon Sections 3(c)(1) and 3(c)(7) largely avoided the issue of over-breadth that arises under the Volcker Rule and the Proposed Rule.

15 *See* Investment Company Act of 1940 § 1(b), 15 U.S.C. § 80a-1 (2011) ("[I]t is hereby declared that the national public interest and the interest of investors are adversely affected … when investors purchase, pay for … or surrender securities issued by investment companies, without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management; … when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers [or] investment advisers … rather than in the interest of all classes of such companies' security holders; … [and] when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities.").

on the exceptions in the 1940 Act, especially Section 3(c)(1) or 3(c)(7), which are unique because they provide quantitative relief based on the number and sophistication of investors and the manner of offering of securities, without regard to a company's activities.[16]

Sections 3(c)(1) and 3(c)(7) of the 1940 Act are the exceptions from the definition of "investment company" for certain private entities.[17] Section 3(c)(1) excepts private entities having fewer than 100 holders of their securities, and Section 3(c)(7) excepts those private entities all of whose security holders are "qualified purchasers".[18] These exceptions can be applied objectively and with a high degree of certainty. As a result, they have been relied on by many entities (beyond traditional hedge funds and private equity funds) that would otherwise be captured by the broad definition of investment company—particularly wholly owned subsidiaries and joint ventures that have far fewer than 100 investors, and others that do not have "investors" at all in the normally accepted sense. Prior to Dodd-Frank, there has been no reason that a company could not rely upon one of these exceptions. The definition of "covered fund" under the Proposed Rule, however, threatens to introduce punitive consequences to banking entities that create,

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16 Although there is more than one way for an issuer to be treated as an "investment company", many companies are captured by the definition in Section 3(a)(1)(C) of the 1940 Act, which generally covers any issuer that owns "investment securities" with a value of more than 40% of the issuer's total assets. Investment Company Act of 1940 § 3(a)(1)(C), 15 U.S.C. § 80a-3 (2011). "Securities", as used in the 1940 Act, is defined using words that are substantially identical to those in the Securities Act of 1933 and very similar to those in the Securities Exchange Act of 1934. Investment Company Act of 1940 § 2(a)(36), 15 U.S.C. § 80a-2 (2011). The staff of the SEC, however, historically has taken the position that many instruments that would not be considered securities for purposes of those laws should be considered securities under the 1940 Act for purposes of analyzing whether an issuer, based on the composition of its assets, is an investment company. As a result, "securities" is interpreted to include assets such as intercompany advances and payables; bank loans and loan participations; accounts receivable; repurchase agreements and reverse repurchase agreements; real estate mortgages; and certain equipment leases.

"Investment securities" are defined as a subset of "securities" that excludes the securities of majority-owned subsidiaries that are not themselves investment companies, U.S. government securities and certain other securities.

Based upon the composition of their balance sheets, many companies are presumptive investment companies and must establish an exception or else register under the 1940 Act. A wholly owned subsidiary of a banking entity that holds nothing but loan participations, for instance, would presumptively be an investment company, but it would qualify for the exception in 3(c)(1) because it has less than 100 investors; it has only one.

17 "Private" in the sense that the entity has not conducted and does not intend to conduct a public offering of its securities.

18 The term generally refers to individuals with an investment portfolio of at least $5 million and entities with an investment portfolio of at least $25 million. *See* Investment Company Act of 1940 § 2(a)(51) and the rules thereunder.

own or invest in companies that rely on Section 3(c)(1) or 3(c)(7). This is the virtually inevitable consequence of taking a broad exception from one statute and attempting to transform it into a prohibition in a basically unrelated statute.

For example, a banking entity that established a wholly owned subsidiary for the sole purpose of holding its non-controlling investments in companies that manufacture and sell machinery (or other industrial or consumer goods) would be prohibited from doing so under the Proposed Rule because the holdings of the subsidiary would be "investment securities"[19] for purposes of the 1940 Act, making the subsidiary presumptively an "investment company". The banking entity would be permitted to hold the very same investments directly. The subsidiary, however, would be an investment company under the 1940 Act but for the availability of Section 3(c)(1) or 3(c)(7) of the 1940 Act, making it a "covered fund" under the Proposed Rule. Therefore, the banking entity would be prohibited from owning this subsidiary. This is an illogical result because the prohibited subsidiary structure does not in any way increase the risk to the banking entity when contrasted with permissible direct ownership of the investments. In fact, the use of a subsidiary structure may *decrease* risk to a banking entity because when establishing a subsidiary a banking entity may choose a form of legal organization that limits liability to the subsidiary. If the Volcker Rule requires banking entities to conduct the same activities directly by prohibiting the use of a subsidiary, it could, perversely, *increase* the potential liability of the banking entity.

Subsidiary structures are widely used. Indeed, some agencies of the U.S. government encourage market participation in programs that require the use of structures that would be covered funds under the Proposed Rule. For example, GECC participates in a Treasury Department-sponsored program called "New Markets Tax Credits" ("NMTC") under Section 45D of the Internal Revenue Code of 1986, as amended, which focuses on encouraging private investment in low-income communities by supporting lending to qualifying businesses in those communities. The NMTC-mandated structure necessitates an equity investment in a subsidiary that is, or is controlled by, a Community Development Entity (as designated by a Treasury Department division) that originates or acquires the loans to the unaffiliated low-income community businesses. Substantially all of the asset side of that subsidiary's balance sheet consists of these loans, causing the subsidiary to be an investment company but for the availability of Section 3(c)(1) or 3(c)(7). As a result, the subsidiary would therefore be a covered fund under the Proposed Rule. Under the terms of the program, a participant such as GECC must not hold the loans on its own balance sheet; it must use the required structure.[20] Another example is the Public-Private Investment Program ("PPIP") organized by the Treasury Department,

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19 *See supra* note 16.

20 Participation in this program should be eligible for an exception under Section 13(d)(1)(E) of the BHC Act, which excepts from the prohibitions of the Volcker Rule certain covered funds that are designed to promote public welfare. Nonetheless it is an example of a government-mandated use of a structure that happens to rely on Section 3(c)(1) or 3(c)(7).

the Federal Reserve, and the FDIC, which was designed to unlock the frozen credit markets and expand lending activity. GECC is a participant in PPIP, which also uses a fund-related structure that seems to rely on either Section 3(c)(1) or 3(c)(7).[21]

We do not believe that Congress intended for the Volcker Rule to be applied in a way that would preclude structures of the sort used in government-supported programs. Even though we believe that the NMTC and PPIP structures should be eligible for an existing exception under the Proposed Rule, they are useful reminders that the Proposed Rule threatens to prohibit companies from using particular legal structures that even the government occasionally requires for certain programs. Moreover, even if an exception under Section 13(d)(1) of the BHC Act applies to the NMTC and PPIP structures, the so-called Super 23A prohibitions (discussed below) would still apply under the Proposed Rule, which threatens to prohibit a wide range of transactions between a banking entity and its affiliates that participate in NMTC or PPIP.

Wholly owned funding subsidiaries, such as those established to issue debt, facilitate intercompany funding and/or manage liquidity do not have external equity investors, but may typically rely on Section 3(c)(1) or 3(c)(7) of the 1940 Act. While certain of these wholly owned funding subsidiaries may hold investments in connection with liquidity management, the exception provided for in Section __.14(a)(2)(iv) of the Proposed Rule is too narrowly drawn to cover these subsidiaries as they often perform non-liquidity management functions as well. Also, many of these subsidiaries are located in foreign jurisdictions and analysis to determine whether these entities could be investment companies that rely on Section 3(c)(1) or 3(c)(7) of the 1940 Act has not been required historically given the scope and location of their activities. As discussed in Part II.E. of this appendix below, the requirement to evaluate whether each of these foreign wholly owned funding subsidiaries would rely on Section 3(c)(1) or 3(c)(7) of the 1940 Act if organized in the United States would be unduly burdensome and potentially result in the disruption of critical funding operations.

These examples are just a few among many that show how the Volcker Rule as interpreted by the Proposed Rule inadvertently prohibits companies from using subsidiaries to structure their otherwise permissible holdings for regulatory, risk management, liability or other legal reasons that have been the historical drivers of certain corporate structures. Congress intended the Volcker Rule to limit certain types of risk, and beyond that objective the Volcker Rule should not be construed to require modifications to the corporate structures essential to the daily operation of banking entities.

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[21] Participation in this program should be eligible for an exception under Section 13(d)(1)(E) of the BHC Act. which excepts from the prohibitions of the Volcker Rule certain covered funds that are designed to promote public welfare. Nonetheless it is an example of a government-mandated use of a structure that happens to rely on Section 3(c)(1) or 3(c)(7).

The Proposed Rule also permits a banking entity to hold an ownership interest in, or act as sponsor to, a joint venture between a banking entity and any other person if the joint venture is an "operating company" and does not engage in any activity prohibited under the Volcker Rule.[22] The Proposed Rule, however, does not define "operating company", nor does it take into account the legislative intent not to disrupt the way in which joint ventures typically operate.

Banking entities are left with no clear guidance on which joint ventures would be permissible under the Proposed Rule. For example, would a joint venture that is a financing company or another type of finance-based joint venture qualify as an operating company? A joint venture that makes loans or acquires participations in loans to third parties does not create the type of risk Congress sought to restrict in adopting the Volcker Rule. Making loans is one of the main activities in which regulators would expect banking entities to be engaged. In fact, loans are not included as a "covered financial position" in the portion of the Proposed Rule that prohibits proprietary trading. Traditional loan activity should not be inhibited through the covered fund prohibitions simply because it is conducted through a legal entity that relies on Section 3(c)(1) or 3(c)(7) of the 1940 Act.

Moreover, the ability to use joint venture structures is beneficial to banking entities because it enables them to more effectively manage risk by allowing other partners to take a portion of it, thereby limiting the banking entity's exposure. As the Agencies noted in the NPR, without an exception for joint ventures and other structures including wholly owned subsidiaries and acquisition vehicles, "many entities would be forced to alter their corporate structure without achieving any reduction in risk."[23] We agree, but believe that the Agencies should have gone even further because the exceptions in the Proposed Rule are too narrow. As we have suggested, the Proposed Rule continues to prohibit structures whose dissolution would actually increase risk.

If the Proposed Rule were implemented without change, banking entities will have to conduct reviews of every one of their potentially thousands of controlled companies and probably all of their joint ventures to determine which of them fall within the definition of a "covered fund". This analysis frequently will not result in a simple "yes" or "no" with respect to a particular subsidiary or joint venture. Banking entities will need to determine first whether each subsidiary or joint venture would be an investment company under the 1940 Act based on its activities and its balance sheet. If so, then someone must decide whether one of the many 1940 Act exceptions other than those in Sections 3(c)(1) and 3(c)(7) would apply to the subsidiary or joint venture. If not, then it is a covered fund and someone familiar with the provisions of the Volcker Rule must make a judgment about whether one of the exceptions in the Volcker Rule or the implementing regulations ultimately adopted by the Agencies applies.

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[22] 12 C.F.R. § 248.14(a)(2)(i).

[23] Proposing Release. *supra* note 2, at 68,913.

These reviews cannot be done only once. Such reviews will need to be performed on a regular basis (quarterly, if the 1940 Act definition of "value" is the applicable standard) because "covered fund" status could occur at any time as a result of changes in balance sheet composition or the activities of a subsidiary or joint venture. Therefore, this process will be very burdensome and expensive, is likely to result mostly in identifying "false positives" *(i.e.*, subsidiaries or joint ventures that no one would consider to be genuine hedge funds or private equity funds), and is likely to disrupt normal business operations. They would therefore produce very little public benefit at substantial cost for banking entities, failing any reasonable cost-benefit analysis.

In addition, given the uncertainty surrounding some of the exceptions in the Proposed Rule (*e.g.*, the meaning of "operating subsidiary"), and the likelihood that such extensive and numerous reviews are going to require further clarity about the scope of prohibited activities and relationships, the Agencies will be faced with the difficult task of evaluating and responding to many requests for clarification and relief.

As mentioned at the beginning of Part II of this appendix, the Proposed Rule does include some other exceptions in Section __.14 for certain liquidity management vehicles and securitization vehicles. We appreciate the Agencies' efforts to provide exceptions for these activities, which we think are necessary, but the proposed exceptions are too narrow and do not go far enough. They would do little to permit the commonly used corporate structures discussed above. The securitization exceptions are discussed further in Part II.D. of this appendix.

B. The application of so-called "Super 23A" to structures that are covered funds but are permitted under an exception to the Volcker Rule destroys the utility of such exceptions

Section __.16 of the Proposed Rule would implement a flat prohibition ("Super 23A") on certain transactions between a banking entity or its affiliates, on the one hand, and a covered fund that the banking entity manages, advises, sponsors, or organizes and offers, on the other hand. The transactions that would be prohibited are those that would be "covered transactions" under Section 23A of the Federal Reserve Act, which generally includes extensions of credit, certain asset purchases, and certain other transactions.[24] This prohibition would apply to hedge funds and private equity funds that are organized or offered pursuant to Section 13(d)(1)(G) of the BHC Act because such vehicles are true hedge funds and private equity funds. The prohibition should also apply to other true hedge funds and private equity funds that are managed, advised or sponsored by a banking entity for the same reason. Under the Proposed Rule, however, this absolute prohibition would also extend to *all* other structures that are covered funds managed, advised, sponsored or organized and offered by the banking entity, but are exempted from the prohibition in Section __.10 of the Proposed Rule. If the final rule implementing the Volcker Rule applies Super 23A to these exempted entities, then the

[24] Federal Reserve Act § 23A(b)(7), 12 U.S.C. 371c(b)(7) (2011).

Agencies effectively would be saying that a banking entity may continue to own these structures, but may not engage in most types of transactions with them. Such a position renders these structures virtually useless, because they will not be able to carry out the purposes for which they were established. For example, a liquidity management vehicle could be prohibited from engaging in transactions to move funds to the affiliates for which it is supposed to be managing liquidity.

The application of Super 23A to covered funds that are permitted pursuant to an exception under the Volcker Rule could result in the illogical situation in which a banking entity is permitted to own the equity of, for example, an investment vehicle under Section 13(d)(1)(J) of the BHC Act, or an acquisition vehicle permitted under Section __.14(a)(2)(ii) of the Proposed Rule, but is not permitted to provide it with cash in the form of a loan. The effect is perverse and would increase the risk to a banking entity. Consider, for example, a joint venture established with a third party that the banking entity and the third party wish to fund in part with equity and in part with debt. The third party can hold part of its investment in the joint venture in equity and part in debt, but the banking entity can only hold equity because of Super 23A. As a result, in the event the joint venture becomes insolvent, the banking entity's investment will be entirely subordinated to the third party's debt investment, thus increasing the risk to the banking entity. This cannot be the result Congress intended.

C. Suggested changes to the definition of "covered fund" to avoid prohibiting firms from structuring their legitimate financial activities using common corporate structures and to limit the unintended application of Super 23A

In adopting a final rule, the Agencies could go a long way toward reducing the dual burdens on banking entities and the Agencies resulting from the comprehensive and ongoing compliance reviews of the assets and activities of banking entities, as well as toward eliminating many of the unintentional consequences of the Volcker Rule that were not intended by Congress, such as the application of Super 23A to otherwise permissible structures. The FSOC also suggested "that Agencies carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in Section 3(c)(1) or 3(c)(7) and consider whether it is appropriate to narrow the statutory definition by rule in some cases."[25]

The FSOC statement indicates that the Agencies have the authority to narrow the statutory definition in some respects. We agree. In the statute, "hedge fund" and "private equity fund" are each defined to mean "an issuer that would be an investment company, as defined in the [1940 Act], but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the [Agencies] may, by rule, as provided in subsection (b)(2), determine."[26] We

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[25] FSOC STUDY, *supra* note 4, at 62.

[26] *See* 12 U.S.C. § 1851(h)(2).

believe that the Agencies should interpret the rulemaking condition to modify both the general definition and the similar funds provision, as opposed to just the similar funds provision. Moreover, the legislative history indicates that Congress did not intend the definition to include a number of common corporate structures that the Proposed Rule appears to include, such as wholly owned subsidiaries and joint ventures. The Agencies should interpret the statute so that the rulemaking condition modifies both the general definition and the similar funds provision in order to avoid these perverse results that clearly were not intended by Congress.

Therefore, we suggest the following changes to the definition of "covered fund":[27]

(i) Exclude wholly owned subsidiaries: All wholly owned subsidiaries of banking entities should be exempted from the definition of "covered fund". There is no meaningful risk of a wholly owned subsidiary being used for evasion because there are no outside equity investors. Wholly owned subsidiaries would still be banking entities and therefore subject to the same restrictions of the Volcker Rule on both proprietary trading and investments in, and relationships with, true hedge funds or private equity funds. Conducting a permitted activity from a wholly owned subsidiary instead of directly does not increase the associated risk to the banking entity; in many cases, it reduces risk. In addition, it avoids the perverse application of Super 23A to common corporate structures. We also note that banking regulators have previously issued guidance indicating that banks should be able to structure their operations through operating subsidiaries or otherwise as they see fit (*see, e.g.,* 12 C.F.R. § 250.141), notwithstanding the prohibition on banks owning common stock, because no purpose would be served in preventing a bank from conducting an activity through a wholly owned subsidiary if it could conduct the activity directly. The same analysis applies here. In fact, the banking entity would perhaps be even better off engaging in some activities through subsidiaries. There are legitimate risk management and other reasons for doing so. We also request that the Agencies clarify that an entity will be considered a wholly owned subsidiary as long as all of the voting equity thereof is owned by its parent company. The issuance of debt securities or nonvoting preferred

[27] We note that other comment letters take the position that the Agencies should define the terms "hedge fund" and "private equity fund" affirmatively by reference to the attributes such funds are traditionally expected to have, either in addition to or in lieu of defining those terms by reference to Sections 3(c)(1) and 3(c)(7) of the 1940 Act. GE and GECC do not object to such an approach as long as investment structures that can demonstrate reliance on an exception to the 1940 Act other than Section 3(c)(1) or 3(c)(7) continue not to be deemed "hedge funds" or "private equity funds".

stock on customary commercial terms by a subsidiary to third parties should not result in its ceasing to be a wholly owned subsidiary as long as the return is not linked to the performance of the issuer or its assets.[28]

(ii) Continue to provide relief for investment in joint ventures, but refine the definition of joint venture to eliminate the "operating subsidiary" requirement: Rather than relying on the requirement that joint ventures be "operating subsidiaries", the Proposed Rule should be modified not only to exempt all joint ventures from the definition of "covered fund", but also to provide a bright-line test to distinguish joint ventures from traditional hedge fund or private equity fund structures. The Agencies should consider limits on the number of joint venturers. Joint ventures tend to have from two to four parties involved as partners or other equity owners of the joint venture. Joint ventures that are primarily controlled by banking entities are themselves also banking entities and are therefore subject to the same limits of the Volcker Rule on both proprietary trading and investments in, and relationships with, hedge funds or private equity funds. There is no meaningful risk of these joint ventures being used for evasion. Alternatively, if the "operating company" requirement is ultimately retained, then it needs to be defined broadly to include most or all of the joint venture structures that do not resemble traditional hedge funds or private equity funds, including joint ventures for financing companies or other finance-based joint ventures.

(iii) Exclude corporate structures and entities that are permitted by Section 13(d)(1) of the BHC Act: In order to avoid these unintended and illogical consequences, the Agencies should expressly exclude from the definition of "covered fund" all corporate structures and entities that are or will be permitted pursuant to Section 13(d)(1) (other than 13(d)(1)(G)) of the BHC Act (either directly or in the Agencies' final rule) on the basis that these are not the types of entities Congress intended to cover when it adopted the Volcker Rule. Other than investments for the benefit of public welfare, which Congress excluded for policy reasons, these structures are not issuers in which a banking entity might "invest" to obtain profit from investing activities; rather, they are

[28] In circumstances where the debt or nonvoting preferred stock contain terms that enable the holder to exert control over the issuer in a manner similar to equity holders, or where the return on such instruments is linked to the performance of the issuer or its assets, it may be less appropriate to consider the issuer a wholly owned subsidiary. However, traditional rights of debtholders and holders of nonvoting preferred stock do not typically have features associated with ownership.

entities that serve business functions or provide business services to banking entities. It would do little good to permit banking entities to hold ownership interests in, and have certain relationships with, these entities if Super 23A still prohibited banking entities from engaging in a variety of transactions with them that are necessary to fulfilling their purpose and utility.

(iv) Create a mechanism that provides flexibility to exclude additional structures: Finally, given the abundance of unintended consequences and the inherent complexity of the Volcker Rule, it is highly likely that regulators will find that they need the flexibility to make further exceptions to the restrictions of the Volcker Rule when necessary to protect the financial system. In order to reduce the regulatory burden discussed above, there should be a process for the Agencies to provide guidance on novel issues in a streamlined and timely fashion. We would suggest that the Agencies consider including in the final rule a general mechanism under Section 13(d)(1)(J) allowing the possibility of further exceptions on an "as needed" basis.

D. Sale and Securitization of Loans

(i) Permitted securitization vehicles should be allowed to hold a broader range of asset classes

The Volcker Rule is intended to address concerns that have nothing to do with the securitization markets *per se*. Namely, it was targeted at concerns relating to the participation of banking entities in proprietary trading and in the sponsorship and ownership of hedge funds and private equity funds. Accordingly, we believe it is appropriate in the final regulations for the Agencies to provide a broad carve-out from the definition of "covered fund" for entities that act as depositors and issuers in securitization transactions.[29]

The existing exceptions in the Proposed Rule are limited. First, they do not except securitization vehicles from the Super 23A prohibitions of the Proposed Rule. There are a variety of reasons that a banking entity may wish to purchase the assets or the securities of its securitization vehicle. For example, other parts of Dodd-Frank require securitizers to retain a certain amount of the credit risk associated with securitization activities; in other words, to have some "skin in the game". Second, although Sections __.13(d) and __.14(a)(2)(v) of the Proposed Rule except interests in certain issuers of asset-backed securities from the general prohibitions of the Volcker Rule, the scope of the assets in which such an issuer may invest needs to be broader. The Proposed Rule

[29] Indeed, perceived problems in the securitization markets were addressed separately in other provisions of Dodd-Frank.

permits only securitization vehicles that are "solely comprised" of loans,[30] contractual rights related to the loans, and certain limited hedging products. Other types of assets, such as debt securities, are typically held by issuers of asset-based securities in order to round out a loan securitization. Occasionally other assets, including repossessed property and equity-like rights, may be held by securitization vehicles in small quantities. The Proposed Rule should permit such holdings in a securitization vehicle to respect the Congressional intent that nothing in the Volcker Rule "limit or restrict the ability of a banking entity … to sell or securitize loans".[31] At a minimum, the Volcker Rule requires a mechanism to provide leeway for holding securities that are ancillary to otherwise permissible securitizations.

In addition, the securitization exceptions should allow for loan securitizations for asset-backed commercial paper ("ABCP") conduits, permitting such vehicles to hold certain notes, certificates or other instruments backed by loans or financial assets that are negotiated by the purchasing ABCP conduit, and to hold liquidity and support commitments provided by their sponsors. These modifications are necessary to allow ABCP conduits to continue to extend credit to bank clients and are consistent with the congressional mandate to continue to permit banking entities to securitize loans.

More broadly, the scope of eligible assets should include at least those assets that would be permissible for an entity that qualifies as an asset-backed issuer under Rule 3a-7 of the 1940 Act. "Eligible assets" for Rule 3a-7 purposes includes fixed or revolving financial assets that, by their terms, convert into cash in a finite period of time (including any rights or other assets designed to assure servicing and timely distribution of proceeds to security holders). We agree with the Agencies that the exceptions for securitization vehicles in the Proposed Rule are needed. Not all securitization vehicles will be able to meet the requirements of Rule 3a-7. Sections __.13(d) and __.14(a)(2)(v) of the Proposed Rule do not go far enough, however. Their eligible asset classes should be at least as broad in scope as those in Rule 3a-7.

(ii) Suggested Changes

(1) Securitization vehicles should be carved out from the definition of "covered fund": Section 13(g)(2) of the BHC Act provides that the Volcker Rule is not to be "construed to limit or restrict the ability of banking entities or nonbank financial companies ... to sell or securitize loans...." The Agencies need to carve out securitization vehicles from the definition of covered fund in order to fulfill this requirement. Otherwise, the prohibitions of Super 23A would still apply, even to securitization vehicles

[30] "Loan" is a defined term in § __.2(q) of the Proposed Rule, meaning any loan, lease, extension of credit, or secured or unsecured receivable. 12 C.F.R. § 248.2(q).

[31] Section 13(g)(2) of the BHC Act.

that qualify for one of the existing exceptions in the Proposed Rule, directly restricting banking entities from selling or securitizing loans in direct contravention of an explicit statutory command. If the Agencies do not take this approach, then Section __.16 of the Proposed Rule should be revised to permit the extensions of credit, credit enhancement mechanisms and purchases of notes if such transactions are done on an arms-length basis in compliance with Section 23B of the Federal Reserve Act.

(2) The securitization exceptions should permit additional asset classes: Certain additional instruments should be permissible in a securitization vehicle. At a minimum, a mechanism is required in order to provide leeway for holding securities that are ancillary to an otherwise permissible securitization. This could be accomplished by expressly permitting debt securities, repossessed property, equity-like rights, equipment lease residuals and other ancillary securities to comprise up to 15% of the assets of the securitization vehicle. The same goal could be accomplished with broader language to the effect that permissible securitization vehicles must "predominantly" (as opposed to exclusively) hold specified asset classes. The exceptions should also allow ABCP conduits to hold the asset classes listed in Part II.D.(i). above, in order to allow them to continue to extend credit.

(3) The securitization exceptions should not be more restrictive than similar exceptions in the 1940 Act: The instruments that are permissible should be expanded to fixed or revolving financial assets that, by their terms, convert into cash in a finite period of time (including any rights or other assets designed to assure servicing and timely distribution of proceeds to security holders).

E. Foreign Funds Concerns

(i) The Proposed Rule creates uncertainty about which foreign entities will be "covered funds" and covers too wide a range of such foreign entities

The Agencies propose to designate as "similar funds" all foreign funds that would be "covered funds" if organized under U.S. law or offered to U.S. residents. This appears intended to capture privately offered non-U.S. funds.

However, the Proposed Rule raises concerns about non-U.S. funds whose U.S. equivalent would rely on an exception to the 1940 Act other than 3(c)(1) or 3(c)(7), but

that, because it is not a U.S. fund, would not qualify for the same exception. For example, there are many secured lending programs that are organized in the United States in reliance on Rule 3a-7. Yet, a structurally similar secured lending program operating outside the United States would generally not rely on the Rule 3a-7 exception because it would not likely have been set up to meet the specific requirements of U.S. law, even though the activities it conducts are essentially the same. Also, U.S. finance subsidiaries that are organized under Rule 3a-5 of the 1940 Act are not covered funds, but foreign entities set up for the same purpose, and which would never have considered conforming with Rule 3a-5 because at the time of formation they would not have needed to for jurisdictional reasons, might be covered funds. That these non-U.S. entities were not originally organized with the requirements of the 1940 Act in mind is yet another example of how burdensome it will be for multinational companies like GE to conduct ongoing reviews of the covered fund status of each of their non-U.S. affiliates. According to the Proposed Rule, banking entities' review of these structures would need to include an analysis of how the structures might have been organized, hypothetically, were they organized in the United States.

Today, the lack of certainty surrounding which foreign funds are intended to be prohibited covered funds is already having an economic impact on companies planning their compliance with the Volcker Rule, as those companies choose not to enter into transactions that could be prohibited under the Proposed Rule, but which Congress did not intend to prohibit. Firms face uncertainty about which of their planned international transactions and structures will comply with the Proposed Rule. It is odd, for instance, that GECC should need to be concerned about the permissibility of its foreign-based loan and securitization programs even though it is clear that U.S. programs that happen to have been established in conformance with exceptions to the 1940 Act other than sections 3(c)(1) or 3(c)(7) are permissible. U.S. firms are placed at a significant disadvantage relative to their foreign competitors due to this overbreadth of the foreign fund definition. U.S. regulators should not jeopardize the foreign activities of U.S. firms through a discretionary application of the "similar funds" authority.

(ii) Suggested Changes

(1) The Agencies should include as covered funds only those foreign funds that exhibit the characteristics of a traditional private equity fund or hedge fund: The statute implementing the Volcker Rule does not require foreign funds to be captured in the definitions of "hedge fund" and "private equity fund" (or "covered fund") by reference to Section 3(c)(1) or 3(c)(7) of the 1940 Act. If the Agencies determine that certain foreign funds should be deemed similar funds, the Agencies have the flexibility to do so through another route. The Agencies should instead require foreign funds to exhibit the characteristics of a "traditional" hedge fund or private equity fund before being deemed to be a "similar fund" and a "covered fund". The rule

should not exacerbate the overbroad nature of the definition of hedge fund and private equity fund. Instead, the Agencies should take this opportunity to avoid creating more unintended consequences of the Volcker Rule.

(2) The Agencies should exclude wholly owned subsidiaries and joint ventures from the definition of "covered fund": As discussed above under Part II.A. of this appendix, we believe that wholly owned subsidiaries and joint ventures should be excluded from the definition of "covered fund". This would ease some of the burden on banking entities that establish lending programs or financing or funding vehicles in non-U.S. jurisdictions that would rely on an exception other than Section 3(c)(1) or 3(c)(7) of the 1940 Act if they had been established in the United States (*e.g.*, those under Rules 3a-5 and 3a-7), but which do not actually rely on such other exceptions because of their non-U.S. status.

III. Unintended consequences of the proprietary trading prohibitions

A. Market Liquidity

(i) The Proposed Rule could result in U.S. businesses being restricted from, or even denied, effective access to capital markets

As mentioned above, we commend the Agencies' efforts to preserve the ability of covered banking entities to make markets in the debt and equity securities of corporate issuers by implementing the statutory exception from the general prohibition on proprietary trading, although we think the Agencies should further delineate the permitted activities.[32] GECC is a large, seasoned debt issuer into the U.S. and international capital markets. We currently have excellent access to these deep and reliable markets. However, we are concerned that the distinction between proprietary trading and market-making and dealing is not adequately addressed in the Proposed Rule. We believe that certain market-making entities may face uncertainty about the extent of permissible market-making activities, which could require them to forgo some activities in order to avoid the risk of non-compliance with a complex set of restrictions. GECC, as a large issuer, may be adversely affected to some degree by this withdrawal, but the effect on smaller corporate issuers—companies instrumental to job creation and economic growth in the United States—could be more acute.

For example, under Section __.4(b)(2)(ii) of the Proposed Rule, covered banking entities would be required to hold themselves out as willing to enter into long and short positions in the covered financial positions for their own accounts and on a regular or

[32] 12 C.F.R. § 248.4.

continuous basis in order to qualify for the market-making exception. There is a lack of clarity about how this will be interpreted, especially in times of significant market stress when market-makers will naturally be more cautious. In addition, Section __.4(b)(2)(iii) of the Proposed Rule requires that the market-making activities be designed not to exceed the reasonably expected near term demands of clients, customers or counterparties. Market-makers will need greater clarity about many components of this requirement, including the nature and source of the reasonable expectation and the scope of "near term".

B. Liquidity Management and Hedging

(i) The Proposed Rule does not allow adequate flexibility for normal liquidity management activities of banking entities

Banking entities actively manage their assets in order to maintain sufficient liquidity to meet their funding needs and comply with applicable laws and regulations. Although we appreciate that the Agencies have provided an exclusion for liquidity management from the prohibition on proprietary trading, the proposed exclusion may be too narrow to permit typical liquidity management approaches in common use today. For example, Section __.3(b)(2)(iii)(C)(1) requires a documented liquidity management plan to specifically contemplate and authorize the particular instruments in the position and circumstances under which such instruments may be used. Because it is not possible to predict with certainty the nature of liquidity stress events or market developments, however, documented liquidity policies generally adopt a principles-based approach, rather than "specifically contemplating" every possible outcome and "authorizing" each particular instrument.

Furthermore, Section __.3(b)(2)(iii)(C)(3) of the Proposed Rule requires that any position taken for liquidity management purposes be limited to financial instruments not expected to give rise to profits or losses as a result of short-term price movements. While it is true that the primary purpose of a liquidity management program should be to provide liquidity rather than generate profits, it is counterintuitive to require banking entities to conduct their liquidity management activities in a way that prohibits any return. The Proposed Rule should not dissuade financial institutions from maintaining their liquidity portfolio in a cost-efficient manner.

In addition, Section __.3(b)(2)(iii)(C)(4) of the Proposed Rule limits positions taken for liquidity management purposes to amounts consistent with the banking entity's "near-term" funding needs. Putting aside the ambiguity of the phrase "near-term", liquidity management activities are not and should not be designed solely to meet the immediate funding needs of banking entities. Many financial institutions rightly consider their long-term funding needs as well as their short-term funding needs to manage liquidity. Under U.S. regulatory guidance, moreover, banking entities should hold

sufficient liquidity to maintain viability over horizons ranging from intraday to periods greater than one year.[33] The Proposed Rule should be revised to permit such plans.

We request that the Agencies reframe the requirement in Section __.3(b)(2)(iii)(C)(1) to recognize the need for flexibility within some established principles, and remove Sections __.3(b)(2)(iii)(C)(3) and __.3(b)(2)(iii)(C)(4) of the Proposed Rule in order to address the above concerns. The remaining requirements of Section __.3(b)(2)(iii)(C)—coupled with the Volcker Rule's anti-evasion provisions—are adequate to ensure that liquidity management transactions are indeed principally for the purpose of managing liquidity rather than prohibited proprietary trading.

(ii) The Agencies should clarify that risk mitigation within an enterprise is not "trading"

Congress intended the Volcker Rule to be a way of limiting trading risks taken by banks and certain other financial institutions. However, financial and non-financial institutions often manage foreign exchange, credit, and interest rate risks on a consolidated basis and in a centralized manner, using one or more affiliated entities to enter into outward facing transactions for the corporate group. In connection with centralized risk management, corporate groups may use swaps between affiliates to manage risk without giving rise to any external market position. This approach facilitates the efficient management of risk and collateral and the availability of netting benefits. Thus, the Agencies should clarify that they will view risk-mitigating hedging activities on an enterprise-wide basis.

An account used to acquire or dispose of the internal positions used in the practice of managing risks across an enterprise in this way does not qualify as a trading account because the internal positions are not taken for the purposes set forth in Section __.3(b)(2)(i) of the Proposed Rule. Accordingly, we request that the Agencies clarify that swaps and other covered financial positions entered into between affiliates for risk management purposes are not deemed to be for the trading account (if any exists) of the banking entity, and are therefore not prohibited proprietary trading.

C. Trading Assets and Liabilities

The Proposed Rule imposes certain quantitative reporting and recordkeeping requirements in connection with the proprietary trading restrictions for those banking entities that, together with their affiliates and subsidiaries, have trading assets and liabilities that equal or exceed $1 billion on a gross basis. Banking entities (together with their affiliates and subsidiaries) for which this number exceeds $5 billion are required to

[33] *See, e.g.*, Interagency Policy Statement on Funding and Liquidity Risk Management, Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Office of Thrift Supervision; and National Credit Union Administration, 75 Fed. Reg. 13,656 (Mar. 22, 2010), at 13,663 and 13,664.

comply with significantly more extensive reporting and recordkeeping obligations, which in some cases may necessitate a burdensome trading metrics monitoring system, than those for banking entities whose gross number is between $1 billion and $5 billion. The Proposed Rule does not contain a specific definition of "trading assets and liabilities". For a BHC, the value of its trading assets and liabilities would typically be reported on one of the Federal Reserve reporting forms that it is required to submit on a periodic basis. For SLHCs, which are not currently required to submit the same forms, these figures may not be determined or reported on the same basis. The Agencies should specify how trading assets and liabilities should be reported for SLHCs.

In particular, the Agencies should clarify that covered financial positions held for hedging or liquidity management purposes (even those held for less than 60 days) should not count as trading assets or liabilities for purposes of the $1 billion and $5 billion thresholds set forth in Appendix A to the Proposed Rule, regardless of whether such positions are deemed to be part of a trading account. The most extensive quantitative reporting and recordkeeping requirements should be limited to banking entities that have substantial trading assets and liabilities due to their significant market-making and underwriting activities. It does not provide a meaningful benefit or make sense to require the heightened reporting and recordkeeping obligations for banking entities such as GECC that do not have major trading operations and could potentially be pushed over the $5 billion threshold based solely on hedging and liquidity management activities that are intended to mitigate other risks.

D. The Volcker Rule should not prohibit the transactions necessary for owners of power and natural gas assets to conduct their business

In the United States, energy-related businesses are heavily regulated. The Agencies should clarify that the Proposed Rule would not prohibit the trading and hedging activities undertaken in the ordinary course by banking entities that own physical assets used in connection with the bulk electric system or the transportation and sale of natural gas, which are both regulated under the jurisdiction of the Federal Energy Regulatory Commission ("FERC") and state public utility commissions ("PUCs"). The contracts entered into and the positions taken in furtherance of the foregoing should be specifically excluded from the definition of a "trading account", and should be deemed by the Agencies not to constitute "proprietary trading", when they are entered into or taken for a commercial purpose by a banking entity in connection with its power and natural gas assets and operations.

The Energy Financial Services division of GECC has interests in a number of companies that own and operate electric generation, transmission lines, natural gas local distribution companies, natural gas pipelines and similar energy infrastructure. The methods by which GECC holds its interests in these companies range from wholly owned subsidiaries to majority owned and managed joint ventures to minority interests in joint ventures. These companies enter into a number of transactions on a day-to-day basis in connection with the sale of natural gas or electricity that, on a literal reading of the

Proposed Rule, could be construed by the Agencies to fall within the definition of "covered financial position". The transactions include, among others, entering into power purchase agreements with utility off-takers, making commitments through an independent system operator or regional transmission organization (collectively, "ISOs") in the day-ahead markets, purchasing or selling transmission congestion rights, acquiring or selling renewable energy credits and natural gas purchased to serve unforeseen customer requirements. These transactions are necessary in connection with the prudent management of electric assets, and in many cases are either encouraged or *required* by FERC, PUCs and/or the relevant ISO. In most cases, for example, all physical electricity produced and transmitted must be cleared through the markets of the applicable ISO.

We are concerned that the definition of "covered financial position" includes "any long, short, synthetic or other position in ... a derivative".[34] The definition of "derivative" in turn includes "any purchase or sale of a nonfinancial commodity for deferred shipment or delivery that is intended to be physically settled".[35] Our concern results from the fact that in the ordinary course, in most U.S. markets, there is some future element involved in the sale of electricity or natural gas, which are commodities for this purpose, by our affiliates. The instruments through which electricity and natural gas are sold may therefore be erroneously interpreted by the Agencies to be covered financial positions within the meaning of the Proposed Rule. If that is the case, some of them may also be deemed by the Agencies to be for the "trading account" of a banking entity because of the short-term nature of some of the instruments and the ways in which they are bought and sold. This relates both to the nature of the electricity markets in the U.S., which have developed around the unique features of electricity (the most important one being that electricity must be used when it is generated and for practical purposes cannot be stored) and the need to respond to fluctuating short-term needs of natural gas customers. The following are a few examples of the types of regulated transactions and markets that have developed as an outgrowth of these constraints.

(i) Many ISOs run both "day-ahead" markets, which typically clear more than 95% of the electricity transactions, and "real time" or balancing markets to schedule the remaining electricity necessary to meet load requirements. These short-term transactions (which could be unintentionally encompassed within the definition of a "covered financial position") might be deemed by the Agencies to be for a trading account, because of the rebuttable presumption that an account is a trading account if it is used to acquire or take a covered financial position that the covered banking entity holds for a period of 60 days or less. However, these transactions are not being entered into for speculative purposes and are in fact a necessary method of selling power into these markets.

[34] 12 C.F.R. § 248.3(b)(3)(i).

[35] 12 C.F.R. § 248.2(l)(i).

(ii) Under mandate from FERC to impose the costs of constrained transmission on the load where the constraint exists, the ISOs also conduct markets for "congestion rights," as a necessary component of the transmission of electricity from the power plant to users, without which the electricity cannot be delivered economically. Although these products are financially settled, they are designed to provide an electric generator with rebates of congestion charges payable by that generator to get its power past a constrained portion of the transmission system.[36]

(iii) "Renewable energy credits" are allocated pursuant to state regulation, upon generation of power by a renewable power plant operator and are integral to the economic generation of renewable power. Renewable energy credits are generally traded through state or regional markets and are held in accounts maintained by the state or regional entity, from which they can be sold "bundled" with physical power or "unbundled" to a utility to satisfy its state-mandated renewable portfolio standards.

(iv) A power plant often contracts for future natural gas fuel deliveries to limit volatility. These transactions are also regulated by FERC. Asset owners usually try to reflect the length of their power supply obligations in the term of these contracts, so they range in term from day-ahead to much longer in length.

(v) A local distribution company which has natural gas delivery obligations to its customers may be required to purchase a portion of its natural gas supplies for a daily or hourly period to meet demand when cold weather hits unexpectedly.

In each case described above (and numerous other similar transactions), the transaction or product, even if traded in a market, is not a speculative trading instrument in the hands of an entity which owns the means of generating that product (*i.e.*, the underlying physical assets), such as GECC, and is entering into the transaction in connection with its business as such and for purposes of managing its physical asset business and the risks related to such business. Indeed, the use of the markets is not just the most advantageous (because it is the most liquid) manner to sell or buy fuels or electric products, in many cases it is the *only* legal manner of doing so. *Without use of some of these products, it is literally not possible to sell electricity into many markets in the U.S.* Other products mentioned, while not literally required, are still customary components of the commercial markets for electricity and natural gas and are therefore necessary from a business perspective for a firm to be able to compete in those markets.

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[36] *See, e.g.*, PJM Manual 06, *Financial Transmission Rights*, Revision 12, 9 (effective July 1, 2009), *available at* http://pjm.com/~/media/documents/manuals/m06.ashx.

While we believe some of the activities described above will certainly qualify under the risk-mitigating hedging activity exception in Section __.5 of the Proposed Rule, it would be helpful to clarify that the exception was intended to apply to all ordinary course, day-to-day operations of the GECC affiliates that own energy assets.

We believe that the Agencies should implement a solution for entities that hold physical power assets or natural gas transmission or distribution assets. The Agencies should clarify that when a banking entity, in connection with its power and natural gas assets and operations, enters into contracts or takes positions for a commercial purpose in connection with the optimization of its assets in the electricity or natural gas markets, it will not be deemed to be doing so for a "trading account," regardless of the duration of such contracts, which may be as short as an hour under FERC regulations.

IV. Conformance period concerns

The Proposed Rule incorporates the final conformance period rules issued by the Federal Reserve under Section 13(c) of the BHC Act on February 8, 2011. The conformance rules are not formally part of the Proposed Rule. Nonetheless, in the NPR, the Federal Reserve requests comments on the conformance provisions.

A. The Proposed Rule requires banking entities to adopt full compliance programs in July 2012, despite the fact that final rules will not be published until shortly beforehand

GE and GECC are strongly committed to a culture of compliance and have already begun considering the scope of the Volcker Rule compliance regime that would be required by the Proposed Rule. Nevertheless, we are very concerned about the timing and scope of the compliance program contemplated by the Proposed Rule. Section __.20 of the Proposed Rule requires banking entities to have compliance programs developed and implemented by the Volcker Rule's effective date of July 21, 2012. Although the statute provided for a two-year conformance period so that banking entities would have time to undertake the difficult task of bringing their activities and investments into conformance with the Volcker Rule, the Proposed Rule does not allow banking entities to build their compliance program during this two-year period. The formation and adoption of the compliance programs required by the Proposed Rule will necessarily be complex and costly. The complexity and cost will unnecessarily increase if the July deadline is maintained for full and complete implementation of a compliance program. Banking entities would have to build compliance programs on the basis of proposed rules and then make last minute changes, potentially of enormous significance. The problem is compounded by the fact that the Proposed Rule explicitly requires a banking entity to have the compliance program in place before it can avail itself of a number of exceptions to the proprietary trading prohibition and the hedging exception to the prohibition on ownership interests in covered funds.[37]

[37] 12 C.F.R. §§ 248.4(a)(2)(i), 248.4(b)(2)(i), 248.5(b)(1), 248.13(b)(2)(i).

The final rule should clarify that compliance program requirements may be phased in over the course of the two-year general conformance period (ending July 21, 2014). This approach would provide ample time to create compliance programs that are more thoughtfully tailored to each specific banking entity and more effective generally. It would also enable banking entities to continue to utilize certain exceptions to the prohibitions of the Volcker Rule if the banking entities are otherwise eligible to do so. In addition, the Agencies should provide guidance to banking entities on this topic as soon as practicable to avoid unnecessary and ultimately mistaken action.

B. The Proposed Rule creates uncertainty about whether the various extensions of the conformance period will be readily available

Dodd-Frank provided a two-year period for companies covered by the Volcker Rule to conform their activities and divest ownership interests in covered funds, plus the opportunity for additional extensions of time if needed. Additional extensions can be granted through a series of three one-year extensions of the conformance period and through a single five-year extension for "illiquid funds". The total time theoretically available under the statute corresponds exactly to the typical life of an LP Fund entered into on May 1, 2010, allowing for an orderly exit from investments in existence before the Volcker Rule. It is logical to believe that in choosing these time periods, Congress intended to grandfather existing investments and encourage the wind down of portfolios in an orderly fashion without unduly stressing the balance sheets of banking entities.

The Federal Reserve should make the Congressional extensions of the conformance period readily available. It could take two or more years to structure a divestiture transaction for certain large funds, including those that are not illiquid under the conformance period rules. Even if a banking entity is actively working to divest a large fund, the market conditions, the contractual terms governing the banking entities investment, or any of the other factors the Federal Reserve may consider under the final conformance period rules[38] could have an effect on the ability of a banking entity to divest the fund quickly and in a way that limits the potential losses a banking entity may incur. One of the main Congressional purposes in adopting the Volcker Rule was to limit unnecessary risk taking that results in losses at banking entities. It would therefore be a paradoxical result if a lack of certainty around the conformance period under the applicable regulations forced banking entities to divest assets in a firesale, resulting in losses that could have been avoided.

It will thus be critical to know with some advance notice whether or not the conformance period extensions will be granted. The Agencies are required under the conformance period rules to respond to an application for an extension within 90 days of the application being deemed complete.[39] We appreciate that the Agencies have built this

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[38] 12 C.F.R. § 248.31(d)(1).

[39] 12 C.F.R. § 248.31(d)(2).

useful approach into the rules. But the Agencies should further clarify the time period within which they will inform a banking entity whether or not its application for an extension is deemed complete. The Agencies should also make clear that a banking entity may apply for the five-year illiquid fund extension prior to the three one-year extensions. The language of the statute does not require one type of extension to occur before the other type. We therefore believe the five-year illiquid fund extension should be made available to banking entities immediately. The circumstances that warrant providing five years to divest an illiquid fund are not likely to change within a one-year period, so subjecting such funds to three one-year extension periods first—especially without certainty from the regulators about whether additional extensions will be available—merely increases the prospects that the illiquid fund will be sold at a discount, causing unnecessary losses for the banking entity.

C. The five-year extension for "illiquid funds" is being interpreted too narrowly

The Proposed Rule implements the five-year extension of the conformance period for illiquid funds too narrowly. In order to qualify for the extension, among other things a banking entity must be contractually committed to invest in or provide additional capital to the illiquid fund.[40] The Proposed Rule indicates that the Agencies will consider such a contractual obligation to exist only if the banking entity cannot terminate its obligation under the terms of the contract, or, if the obligation can be terminated with the consent of other persons, the banking entity has attempted and failed to obtain consent.[41] Most typical fund investments are transferable with the consent of the general partner, and many have some sort of "regulatory out" provisions that allow a banking entity to get out of certain contractual commitments if fulfilling them would violate an applicable law or regulation. The Agencies might interpret these provisions to mean that a banking entity is not contractually committed to invest in or provide additional capital to the fund. In practice, however, not only are these regulatory out provisions difficult to actually utilize, but they also raise a host of questions about when they are available. For example, would the Agencies expect banking entities to invoke such provisions during the conformance period, and are the regulatory out provisions available during the conformance period? What about during any extensions of the conformance period? Some regulatory out provisions allow investors to refrain from additional capital contributions that would otherwise be required, but do not allow the transfer of any existing holdings. The Agencies should refrain from forcing banking entities to invoke such provisions because in such cases the banking entity would still be exposed to a risk of loss in the fund and its interest, if transferable, would certainly be sold at a discount, forcing unnecessary losses on the banking entity.

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[40] 12 C.F.R. § 248.31(b).

[41] 12 C.F.R. § 248.31(b)(3)(iii).

The narrow approach taken in the current conformance period rule would mean that even if a fund holding was completely "illiquid" in the market sense of the word—meaning there are no ready buyers at a reasonable price—the fund still may not be eligible for this extension of the conformance period. This approach in the Proposed Rule prioritizes the theoretical availability of a transfer over actual market liquidity of the fund. This narrow view could lead to market disruptions and increase the risk of loss to banking entities because, by forcing the sale of an illiquid fund, an asset that may have future potential losses or gains is disposed of in favor of actual realized losses. Generally, the Agencies should take a more liberal view of what constitutes a contractual obligation to acquire or retain an ownership interest in, or commit additional capital to, an illiquid fund. In particular, the Agencies should not interpret the existence of regulatory out provisions to mean that a banking entity is not contractually obligated to acquire or retain an ownership interest in, or commit additional capital to, an illiquid fund.