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By Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20551

Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20520

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **Federal Reserve Docket No. R-1432 and RIN 7100 AD 82; OCC Docket ID OCC-2011-14; FDIC RIN 36064-AD85; SEC File No. S7-41-11:**
Notice of Proposed Rulemaking - Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

National Australia Bank Limited ("NAB") appreciates the opportunity to comment on the Notice of Proposed Rulemaking (the "Proposed Rules")[1] jointly issued by the Board of Governors of the Federal Reserve System (the "Board"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission (collectively, the "Agencies") to implement Section 13 of the Bank Holding Company Act of 1956, as amended (the "BHC Act"). Section 13 was added by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and is commonly referred to as the "Volcker Rule." The Volcker Rule generally prohibits banking

[1] 76 Fed. Reg. 68846 (Nov. 7, 2011).

entities such as NAB from engaging in proprietary trading and sponsoring or investing as principal in private equity and hedge funds ("covered funds").

Background and Summary

NAB is one of Australia's largest financial institutions and conducts substantial wealth management business through its wealth management division, MLC. NAB is also a bank holding company registered with the Board under the BHC Act and thus is subject to the Volcker Rule and the implementing regulations with respect to its worldwide activities as well as those conducted in the United States, including the investment activities conducted by its subsidiaries in the MLC wealth management division.

MLC's customers, which are entirely Australian and New Zealand residents, invest through MLC in, among other assets, private equity and hedge funds in three principal ways: (i) through MLC superannuation funds,[2] (ii) through MLC non-superannuation funds (together with the MLC superannuation funds, the "MLC Funds") and (iii) through life insurance policies issued by MLC Limited ("MLCL"), an Australian registered life insurance subsidiary of NAB regulated by the Australian Prudential Regulation Authority ("APRA"). Each of the MLC Funds is an Australian trust and subject to regulation by APRA and/or the Australian Securities and Investments Commission ("ASIC").[3] Because MLC entities that are subsidiaries of NAB act as trustees of the MLC Funds, the MLC Funds are themselves considered subsidiaries of NAB under the BHC Act,[4] even though they hold only customer funds. NAB does not invest in the MLC Funds, and the assets of the MLC Funds are not recorded on the books of NAB.

Whilst we acknowledge the basic purpose of the Volcker Rule — to promote and enhance the safety and soundness of banking entities and the financial stability of the internationally important U.S. financial system — and appreciate the significant effort by the Agencies in developing the Proposed Rules, we believe that the Proposed Rules in several respects do not accurately reflect the statutory provisions of the Volcker Rule or Congressional intent and may unnecessarily and adversely impact non-U.S. banks' traditional wealth management business, as authorized and regulated under local laws, as well as their customers.

The Proposed Rules impact the wealth management business of non-U.S. banks that are banking entities under the Volcker Rule and their customers in two principal and, we believe, unintended ways:

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[2] Superannuation is a pension scheme in Australia under which employers are required by the Superannuation Industry (Supervision) Act of 1993 to make compulsory contributions to superannuation funds on behalf of their employees. Employees may also make voluntary contributions to the superannuation funds. Superannuation contributions are invested over the period of the employees' working lives and can be accessed when the employees retire. Currently, MLC manages 12 superannuation funds. In addition to the retirement savings-related superannuation funds, MLC also manages approximately 90 non-superannuation funds.

[3] The MLC superannuation funds, which are regulated by APRA, are offered publicly to Australian residents only. The MLC non-superannuation funds, which are regulated by the ASIC, are offered publicly to Australian and New Zealand residents only. The offering of the MLC Funds is regulated by the Corporations Act 2001 (Cth).

[4] Because NAB subsidiaries serve as trustees of the MLC Funds, the MLC Funds are deemed to be controlled by NAB for purposes of the BHC Act.

First, non-U.S. insurance companies (that are affiliated with non-U.S. banks that are banking entities under the Volcker Rule) may not be able to diversify into covered funds for their general account or for the separate accounts of their customers, and may be required to prematurely divest existing investments in covered funds made in good faith before the effective date of the Volcker Rule, potentially at a financial loss to them and their customers. We consider that the impact of the Proposed Rules in these ways not only increases risk by limiting sound financial diversification policy but also does not take account of explicit exemptions provided by Congress in the Volcker Rule itself for banking entities acting on behalf of their customers or for the general account of an insurance company.

Second, such non-U.S. banks may not be permitted to diversify investments on behalf of customers through covered funds and may be required to prematurely divest their current investments in covered funds, again potentially at a financial loss to them and their customers.

The potential adverse impact of the Proposed Rules on the wealth management business of non-U.S. banks is unnecessary to achieve the purpose of the Volcker Rule to limit risk to U.S. banking organizations and U.S. financial stability. To the extent that non-U.S. banks and their affiliated non-U.S. insurance companies invest, with only customer funds, in covered funds, the capital of such non-U.S. banks is not placed at risk in such covered fund investments. As a result, such investments would not adversely affect the U.S. financial stability.

In particular, we urge that the Proposed Rules should be modified in the following ways:

I. the exemptions for proprietary trading for the general account and separate accounts of regulated insurance companies in the Proposed Rules should also be available for investments in covered funds made for these accounts in accordance with the terms of the Volcker Rule;

II. the definition of banking entity should not include covered funds that a banking entity may invest in, sponsor or control under the Volcker Rule;

III. the definition of banking entity should not include non-U.S. funds that are substantially similar to U.S. registered investment companies (so called "mutual funds") in terms of their activities and regulation; and

IV. the exemption in the Proposed Rules for covered fund investments made in good faith in a fiduciary capacity should be available for long-term trusts that qualify as "companies" under the BHC Act definition, so long as those trusts are not themselves bank holding companies.

I. Insurance companies

The ability of insurance companies to diversify their investment (with insurance premiums) is of fundamental importance to the business of insurance and these activities are subject to extensive statutory and regulatory limitations. As a result, Congress included in the Volcker Rule specific direction that the implementation of the Volcker Rule must "appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system."[5] We believe the Proposed Rules do not reflect this explicit Congressional intent that the agencies accommodate the business of insurance with respect to these investment activities. Indeed, as discussed below, we believe the Proposed Rules ignore the express exemptions from the Volcker Rule's limitations on investments in covered funds by regulated insurance companies.

A. The Volcker Rule exemption for transactions for the general account of a regulated insurance company permits covered fund investments.

We consider that the Proposed Rules improperly restrict the Volcker Rule's exemption for transactions for the general accounts of regulated insurance companies only to proprietary trading. By its terms and as intended by Congress, the exemption applies also to the purchase or acquisition of interests in covered funds. Interpreted otherwise, the Proposed Rules, if adopted, would significantly and negatively affect the ability of regulated insurance companies to diversify their investment portfolios in order to meet future obligations to policyholders as well as limiting their ability to provide investment capital to the U.S. economy.

The general account exemption in Section 13(d)(1)(F) of the BHC Act provides that, notwithstanding the Volcker Rule prohibitions, "[t]he purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company" is permitted, subject to certain conditions.[6]

Although the Proposed Rules provide an exemption from the proprietary trading prohibition with respect to the general accounts of regulated insurance companies that are affiliated with banking entities,[7] the Rules do not make this exemption available to covered fund investments by regulated insurance companies. Both the terms and legislative history of the Volcker Rule support the view that the general account exemption should not be so limited.

It is a rule of statutory construction that the terms of a statute must be interpreted in accordance with their plain meaning absent extraordinary circumstances.[8] The "purchase" and "acquisition" of "securities and other instruments described in subsection (h)(4)" by regulated insurance companies are explicitly permitted by subsection (d)(1)(F) of the Volcker Rule. Read plainly, the reference to the set of instruments listed in subsection (h)(4) includes equity interests in covered funds. Because there is no language in subsection (d)(1)(F) or elsewhere to suggest that such exemption is available only for proprietary trading, it should not be limited in that way.

If Congress had intended the general account exemption in subsection (d)(1)(F) to apply only to proprietary trading, Congress could have simply used the phrase

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5 12 U.S.C. § 1851(b)(1)(F).

6 12 U.S.C. § 1851(d)(1)(F).

7 *See* Proposed Rules §_.6(c). Regulated insurance companies that are affiliated with banking entities are referred to as regulated insurance companies hereafter.

8 *See e.g.*, Board of Governors v. Dimension Financial Corp., 474 U.S. 361, 368 (1986); *see also* Patagonia Corp. v. Board of Governors, 517 F.2d 803, 810 n.10 (9th Cir. 1975).

"[p]roprietary trading conducted by a regulated insurance company" instead of the phrase "[t]he purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company." Indeed, this is precisely what Congress did in subsection (d)(1)(H) of the Volcker Rule when it exempted from the proprietary trading prohibition activities by foreign banking organizations solely outside the United States.[9]

Moreover, the legislative history of subsection (d)(1)(F) of the Volcker Rule indicates that the general account exemption applies to covered fund investments. According to Senators Merkley and Levin, the principal authors of the Volcker Rule,

> Subparagraph (d)(1)(F) is meant to accommodate the normal business of insurance at regulated insurance companies that are affiliated with banks. The Volcker Rule was never meant to affect the ordinary business of insurance: the collection and investment of premiums, which are then used to satisfy claims of the insured. These activities, while definitionally proprietary trading, are heavily regulated by State insurance regulators, and in most cases do not pose the same level of risk as other proprietary trading.[10]

The Merkley-Levin Colloquy indicates that the Volcker Rule did not intend to affect the normal business of insurance companies, including their ability to invest customer insurance premiums. Further, the level of risk from the investment activities for the general account of regulated insurance companies is minimized because, as Senator Merkley noted, such investment activities "are heavily regulated" by insurance regulators.[11]

In practice, in order to support long-term liabilities to policyholders, a regulated insurance company like MLCL would typically invest in long-term assets for proper asset-liability management. The limitation of the general account exemption in the Proposed Rules would adversely affect the normal business operations by limiting the ability to fully diversify investment portfolios for the benefit of policyholders/customers. As a result, the limitation of the general account exemption in the Proposed Rules is inconsistent with the intent of Congress to accommodate the business of insurance and the terms of the statute itself.

B. The exemption in the Proposed Rules for proprietary trading for the separate accounts of regulated insurance companies should also permit covered fund investments.

We also believe that the exemption in the Volcker Rule for transactions "on behalf of customers" permits investments in covered funds by regulated insurance companies (as

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9 Section 13(d)(1)(H) of the BHC Act provides that notwithstanding the Volcker Rule prohibitions, "[p]roprietary trading conducted by a banking entity pursuant to paragraph (9) or (13) of section 4(c), provided that the trading occurs solely outside of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States" is permitted. 12 U.S.C. § 1851(d)(1)(H) (emphasis added).

10 156 Cong. Rec. S5896 (daily ed. July 15, 2010) (colloquy between Sen. Merkley and Sen. Levin) (the "Merkley-Levin Colloquy") (emphasis added).

11 Although the Merkley-Levin Colloquy used the term "proprietary trading," it was used as a general reference to "the collection and investment of premiums." An insurance company's investment of premiums generally includes both short-term trading activities and long-term investments.

well as other types of financial institutions) for the separate accounts of their customers.

Section 13(d)(1)(D) of the BHC Act provides that notwithstanding the Volcker Rule prohibitions, "[t]he purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers" is permitted.[12] In implementing this provision, the Proposed Rules provide an exemption from the proprietary trading prohibition for the trading activities of regulated insurance companies for the separate accounts of their customers, subject to certain conditions (the "Separate Account Exemption").[13] The Proposed Rules, however, are silent on whether the Separate Account Exemption would be applicable to covered fund investments by regulated insurance companies. Both the terms and legislative history of the Volcker Rule support the view that the Separate Account Exemption should also be applicable to covered fund investments by regulated insurance companies for the separate accounts of their customers.

As in the case of the general account exemption discussed above, the phrase "securities and other instruments described in subsection (h)(4)" is a reference to the set of instruments listed in subsection (h)(4), which includes equity interests in covered funds. The purchase or acquisition of such interests in covered funds on behalf of customers is thus permitted under subsection (d)(1)(D) and the Separate Account Exemption in the Proposed Rules should be amended to reflect this statutory language. There is no language in subsection (d)(1)(D) to suggest that this exemption for transactions "on behalf of customers" is available only for proprietary trading. As noted above, had Congress so intended, it could have simply used the phrase "[p]roprietary trading conducted by a regulated insurance company" instead of "[t]he purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company."

In addition, there is no logical or policy reason to permit regulated insurance companies to engage in proprietary trading and not invest in covered funds. When Congress directed that the implementation of the Volcker Rule "must accommodate the business of insurance," Congress did not make a distinction between proprietary trading and covered fund investments by regulated insurance companies. There is nothing in the legislative history of the Volcker Rule or the Proposed Rules to suggest that the latter involves higher risk.

This construction of the Separate Account Exemption in subsection (d)(1)(D) is also supported by the purpose of the Volcker Rule to limit risk to the capital position of banking entities. When banking entities make covered fund investments on behalf of customers — including for separate accounts for customers of a bank-owned insurance company — they do not place their capital at risk. The investment risk is borne entirely by the customers. Consequently, prohibiting a banking entity from investing in covered funds on behalf of customers would not promote the safety and soundness of the banking entity, nor would it serve any of the other public goals of the Volcker Rule. In fact, it would adversely affect the competitive position of banking organizations and unnecessarily restrict the investment options available to their customers.

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12 12 U.S.C. § 1851(d)(1)(D).

13 *See* Proposed Rules §_.6(b)(iii). Insurance company separate account trading activities are one of three types of trading activities that would be exempted under §_.6(b) of the Proposed Rules pursuant to the "on behalf of customers" exemption provided under subsection (d)(1)(D) of the Volcker Rule.

II. The definition of banking entity should not include any covered funds.

Although the Preamble to the Proposed Rules states that covered funds that are exempt from the Volcker Rule would not be included as banking entities, Section _.2(e)(4) of the Proposed Rules itself limits this treatment to covered funds that are organized, offered and held by a banking entity pursuant to Section 13(d)(1)(G) of the BHC Act. We believe that the definition of banking entity should be revised to exclude all covered funds that a banking entity has permissibly sponsored or made an investment in to be consistent with the purpose and intent of the Volcker Rule.

We support the statement of the Agencies in the Preamble to the Proposed Rules that the definition of banking entity does not include covered funds that are controlled permissibly by a banking entity under the Volcker Rule. Otherwise, such covered funds "would become subject to all of the restrictions and limitations of section 13 of the BHC Act and the proposed rule, which would be inconsistent with the purpose and intent of the statute."[14]

The Agencies correctly pointed out in the Preamble to the Proposed Rules that "in order to avoid application of Section 13 of the BHC Act in a way that appears unintended by the statute and would create internal inconsistencies in the statutory scheme, the proposed rule also clarifies that the term 'banking entity' does not include any affiliate or subsidiary of a banking entity, if that affiliate or subsidiary is (i) a covered fund, or (ii) any entity controlled by such a covered fund."

This is an important clarification because the definitions of "affiliate" and "subsidiary" under the BHC Act are broad, and could include a covered fund that a banking entity has permissibly sponsored or controls under one of the exemptions in the Volcker Rule. This clarification is especially important for foreign banking organizations. A foreign banking organization may invest in covered funds solely outside the United States pursuant to Section 13(d)(1)(I) of the BHC Act. If, however, the foreign banking organization also controls such covered funds, such covered funds would be banking entities and subject to the Volcker Rule prohibitions, a result unintended by Congress.

Consistent with the decision of the Agencies to exclude covered funds exempt under Section (d)(1)(G) from the Volcker Rule prohibition, we consider that covered funds exempt under other sections of the Volcker Rule, such as Section 13(d)(1)(I), should also be excluded. Further, we see no policy reason to limit the exclusion to covered funds that are organized, offered and held by a banking entity pursuant to Section 13(d)(1)(G) of the BHC Act.

Accordingly, in the interests of fairness and competitive equality, to effectuate the intent of Congress, and consistent with the Agencies' statement in the Preamble, we believe that the reference to "§_.11" should be removed from the definition of banking entity thereby treating similarly situated funds consistently.

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14 76 Fed. Reg. 68846, (Nov. 7, 2011) p. 68856.

III. The definition of banking entity should not include non-U.S. funds that are similar to U.S. regulated investment companies (so called "mutual funds").

We believe that the definition of banking entity should exclude non-U.S. funds that are similar to U.S. registered investment companies, or "mutual funds", because such non-U.S. funds are similarly offered to the general public and are heavily regulated by their home country regulators.

U.S. mutual funds that are sponsored and distributed by a U.S. bank or bank holding company are not generally subsidiaries of the associated bank or bank holding company.[15] As a result, a U.S. mutual fund would not be covered by the definition of "banking entity" under the Proposed Rules and, therefore, not subject to the Volcker Rule restrictions even when such a mutual fund is seeded, advised and distributed by a banking entity.

The principle of competitive equality dictates that non-U.S. funds (that hold only customer funds) that are substantially similar to U.S. mutual funds should not be covered by the definition of banking entity. From a policy perspective, applying the Volcker Rule restrictions to such non-U.S. funds would not promote the safety and soundness of the banking entity involved, nor would it serve any of the other public goals of the Volcker Rule. Indeed, it would restrict the flow of capital from non-U.S. entities to the United States, without any benefit to the safety or soundness of the U.S. financial system.

As a result, we believe that the "banking entity" definition should not include non-U.S. funds that are substantially similar to U.S. mutual funds, but would otherwise be a banking entity due to the legal structures under which such non-U.S. funds are established.

IV. The exemption in the Proposed Rules for covered fund investments made in good faith in a fiduciary capacity should be available for long-term trusts that constitute "companies" under the BHC Act definition, so long as those trusts are not themselves bank holding companies.

The Proposed Rules make it clear that the Volcker Rule prohibition with respect to investments in covered funds does not apply unless a banking entity is acting as a principal.[16] The Preamble to the Proposed Rules specifically provides, among other examples, that investments made by a banking entity acting in good faith and in a fiduciary capacity are not treated as investments as principal (the "Fiduciary Exemption").[17]

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15 *See* 76 Fed. Reg. 68846, (Nov. 7, 2011) p. 68856.

16 *See* Proposed Rules §_.10(a).

17 The Preamble provides that "the proposed rule would not prohibit the acquisition or retention of an ownership interest (including a general partner or membership interest) in a covered fund: (i) By a banking entity in good faith in a fiduciary capacity, except where such ownership interest is held under a trust that constitutes a company as defined in section (2)(b) of the BHC Act . . . ." 76 Fed. Reg. 68846, (Nov. 7, 2011) p. 68896.

We support this clarification of the Volcker Rule, but we believe that the availability of this Fiduciary Exemption should not depend on whether the banking entity is acting as trustee for a trust that complies with the archaic Rule Against Perpetuities.[18] This Fiduciary Exemption should also be available when a banking entity is acting as trustee for a long-term trust that does not comply with the Rule Against Perpetuities. In both cases, the banking entity is not acting as principal, but rather in good faith as a fiduciary on behalf of its customers. The fact that the trust is a "company" under the BHC Act is irrelevant to the status of the banking entity as a fiduciary.

Moreover, the Fiduciary Exemption precisely mirrors the fiduciary exemptions for acquisitions of bank and nonbank shares in Sections 3(a) and 4(c)(4) of the BHC Act, which are not so limited under long-standing and well-settled Board precedent unless the trust is itself a bank holding company. This Board precedent is fully consistent with the relevant legislative history and the purposes of the BHC Act and was specifically reaffirmed by the Board in its 1983 rulemaking comprehensively revising Regulation Y.

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If you have any questions or comments with respect to any of the matters discussed in this letter, please contact Jay Son Yoong, Senior Legal Counsel, of my office (+61-2-9466-7404 or jayson.yoong@nab.com.au).

Yours sincerely,

Stephen P. Tudjman
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18 For a trust to avoid classification as a "company" under the BHC Act, it must by its terms terminate within 25 years or not later than 21 years and 10 months after the death of individuals living on the effective date of the trust. *See* 12 U.S.C. 1841(b). The legislative history of the 1970 amendments to the BHC Act indicates that this formulation was enacted because, at the time of the amendments, "[m]any wills [had] been drawn to comply with the long-established legal 'rule against perpetuities'." Sen. Rep. No. 1179, 89th Cong., p. 7 (May 19, 1966). However, with many states having since modified or repealed the rule against perpetuities, and certain changes to the federal tax laws favoring the use of perpetual trusts, the limitations on trusts based on the rule against perpetuities in the 1970 amendments to the BHC Act should no longer be relevant.