March 27, 2020

BANK POLICY INSTITUTE *Via Electronic Mail*

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1694; RIN 7100–AF70

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN: 3064–AF17

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581
RIN: 3038–AE93

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
File No. S7–02–20

Chief Counsel's Office
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC–2020–0002

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

Ladies and Gentlemen:

The Bank Policy Institute[1] is pleased to comment on the notice of proposed rulemaking (the "**NPR**")[2] issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission and the Commodity Futures Trading Commission regarding the agencies' proposed amendments to the covered funds provisions (the "**Proposed Rule**")

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1 BPI is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make 72% of all loans, including nearly half of the nation's small business loans, and serve as an engine for financial innovation and economic growth.

2 85 Fed. Reg. 12120 (Feb. 28, 2020).

of the current rule (the "**Current Rule**") implementing Section 13 of the Bank Holding Company Act (the "**BHC Act**"), commonly referred to as the "**Volcker Rule.**"[3]

We welcome the agencies' continued efforts to improve and streamline the Current Rule and believe the Proposed Rule largely achieves the agencies' goal of "provid[ing] clarity to banking entities so that they can offer financial services and engage in other permissible activities in a manner that is consistent with the [Volcker Rule]."[4] We, therefore, support a number of the agencies' proposed changes to the covered funds provisions as they have been carefully crafted to address the financial needs of bank customers without creating risk for banking entities. However, certain additional steps and clarifications are necessary to further improve the Current Rule while remaining consistent with the Volcker Rule's statutory purpose.

We also support the recommendations regarding venture capital funds and credit funds that are discussed in a comment letter being submitted by the Securities Industry and Financial Markets Association.

I. Executive Summary

The recommendations in this letter focus on proposals and questions in the NPR that are particularly relevant to commercial banks.[5] We share the agencies' view that, based on experience in implementing the Current Rule, "new exclusions from the covered funds provisions [are needed] to address the potential over-breadth of the covered fund definition and related requirements."[6] Many of the Current Rule's exclusions to the "covered fund" definition are drawn too narrowly and we appreciate the agencies' efforts in the Proposed Rule to reframe certain existing covered funds exclusions and provisions, adopt additional exclusions and make other targeted revisions to the Current Rule that would allow banking entities to offer traditional commercial banking, asset management and custodial services to customers and engage in other permissible activities.[7] We respectfully submit the following recommendations and urge the agencies to finalize the amendments to the Current Rule expeditiously.

This letter is organized as follows:

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3 The Volcker Rule was added to the BHC Act by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5535 (Jan. 31, 2014); *see also* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 61974 (Nov. 14, 2019) (the "**2019 Amendments**").

4 NPR at 12123.

5 We also refer the agencies to the comments submitted by BPI to the agencies on October 17, 2018 in connection with the agencies' July 2018 notice of proposed rulemaking (83 Fed. Reg. 33432 (July 17, 2018)) (the "**2018 NPR**"), *available at* https://bpi.com/wp-content/uploads/2018/10/BPI_Volcker_Rule_NPR_Comment_Letter_2018.pdf ("**BPI's 2018 Comment Letter**") and by The Clearing House Association, L.L.C. to the Request for Public Input issued by the Office of the Comptroller of the Currency, Proprietary Trading and Certain Interests in and Relationships with Covered Funds, *available at* https://www.theclearinghouse.org/-/media/tch/documents/tch-weekly/2017/20170921_tch_-_comment_letter_to_occ_volcker_request_for_comment.pdf.

6 NPR at 12123.

7 Although this letter sets forth a number of potential clarifications and recommendations in respect of the Proposed Rule, it is important to underscore that banking entities will continue to make determinations as to the covered fund status of particular entities consistent with past practice and guidance, except as may be modified by any final regulations. In many cases, therefore, we view the Proposed Rule's additional exclusions and amendments as providing banking entities with non-exclusive relief from the Volcker Rule's covered funds restrictions.

- Section II discusses the following modifications to certain aspects of the Proposed Rule's provisions:

    - The foreign public fund exclusion should be revised to (i) confirm that FPFs listed on an internationally-recognized exchange that permits trading for retail investors are presumed to qualify for the exclusion, (ii) eliminate the director and senior executive officer ownership limitation and (iii) align the post-seeding period ownership interest limits in sponsored foreign public funds with those permissible for registered investment companies;

    - The agencies should confirm that the customer facilitation vehicle exclusion would permit a third-party unaffiliated with the client (and not only a banking entity) to hold a *de minimis* ownership interest in the vehicle for corporate and administrative purposes;

    - The family wealth management vehicle exclusion should be amended to (i) allow the ownership of non-trust vehicles to include up to 10 closely-related persons, (ii) clarify that any third-party unaffiliated with the family customers may hold a *de minimis* ownership interest in the vehicle for corporate and administrative purposes and (iii) expressly provide banking entities with the flexibility to tailor the investor disclosure obligations to the specific circumstances of each particular family wealth management vehicle;

    - The agencies should clarify that the loan securitization exclusion's non-loan asset limit should be calculated relative to the original size of the securitization's total collateral pool and the par value of the securities or assets on the day they are acquired;

    - The safe harbor from the definition of "ownership interest" for certain senior loans and senior debt instruments should be clarified to address the effect of accelerated amortization in respect of fixed principal payments;

    - We support the agencies' amendments to Super 23A to include the exemptions provided under Section 23A of the Federal Reserve Act and Regulation W for purposes of interpreting Super 23A, but recommend the agencies confirm that (i) the exemptions in Regulation W applicable to "securities affiliates" are available to covered funds in the Volcker Rule context, (ii) Regulation W's prohibition on the purchase of low-quality assets does not apply to transactions that banking entities facilitate as riskless principal for family wealth management vehicles, and (iii) certain other ordinary extensions of credit to advised or sub-advised third-party covered funds are also exempt from Super 23A;

- Section III discusses the following provisions of the Proposed Rule, which should be adopted as proposed:

    - We agree with the agencies' proposed rule of construction on parallel investments and co-investments with covered funds;

    - We support the agencies' clarification that CRA-qualified investments and permissible public welfare investments under other applicable regulations are excluded from the covered funds restrictions;

- We welcome the agencies' proposed codification of the guidance related to qualifying foreign excluded funds in the amendments to the Current Rule;

- We support the agencies' proposed revisions to the exclusion for small business investment companies to account for their entire life cycle, including SBICs' wind-down phase;

➢ Section IV discusses the following additional recommendations in respect of the Current Rule or the Proposed Rule, which were not specifically addressed in the Proposed Rule but should be included in any amendments to the Volcker Rule regulations:

- The agencies should revise the "banking entity" definition to exclude public welfare and community development funds (including those engaged in CRA-qualified investments) and employees' securities companies;

- The agencies should adopt an exclusion for a banking entity's erroneous acquisition or retention of an ownership interest in a covered fund, consistent with the Current Rule's exclusion for error trades in the proprietary trading context;

- The agencies should expressly codify the previous staff guidance regarding the seeding period for RICs and FPFs in an amendment to the Current Rule; and

- The agencies should extend the investment limit and capital deduction relief provided for ownership interests in third-party covered funds held as permissible underwriting or market-making positions to such positions held in sponsored or advised covered funds.

II. Modifications to the Proposed Rule

The agencies should adopt the refinements to the Proposed Rule's exclusions and other provisions described below to enable banking entities to engage in permissible activities that are not intended to be captured by the Volcker Rule's covered funds prohibition.

A. The foreign public fund exclusion should be revised to (i) confirm that FPFs listed on an internationally-recognized exchange that permits trading for retail investors are presumed to qualify for the exclusion, (ii) eliminate the director and senior executive officer ownership limitation and (iii) align the post-seeding period ownership interest limits in sponsored foreign public funds with those permissible for registered investment companies.[8]

The Proposed Rule amends and streamlines the foreign public funds ("FPF") exclusion by eliminating the "home jurisdiction" requirement and the requirement that ownership interests be sold "predominantly" through public offering.[9] The agencies propose to replace such requirements with a condition that the FPF be authorized to offer

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8 This section is responsive to Questions 6–10 in the NPR.

9 NPR at 12127. Under the Current Rule, a FPF must be organized or established outside the United States and the ownership interests of the fund must be (i) authorized to be offered and sold to retail investors in the issuer's "home jurisdiction" and (ii) sold

and sell ownership interests and such interests are offered and sold through one or more public offerings.[10] The Proposed Rule also modifies the definition of "public offering" to add a new requirement that the distribution be subject to substantive disclosure and retail investor protection laws or regulations.[11]

BPI welcomes these changes to the FPF exclusion as they would significantly increase the utility of the FPF exclusion, enhance consistency in the treatment of U.S. registered investment companies ("**RICs**") and foreign retail funds under the Volcker Rule and alleviate the compliance and monitoring burden associated with the existing FPF exclusion. One way the agencies can further clarify the scope of the FPF exclusion is to confirm that non-U.S. funds that are listed on an internationally-recognized exchange that permits trading for retail investors are presumed to meet the Proposed Rule's revised "public offering" prong and, therefore, qualify for the exclusion. Such a bright-line standard would help to eliminate any remaining uncertainty surrounding the exclusion's availability to foreign funds that are similar to U.S. RICs.

In addition, the Proposed Rule amends the requirement, which applies solely in respect of U.S. banking entities that serve as sponsors to a FPF, on sales of ownership interests in the fund to employees of the sponsoring banking entity, the issuer or affiliates of such entities. The agencies propose that the FPF must be sold predominantly to persons other than the sponsoring U.S. banking entity or the issuer (or affiliates of the sponsoring banking entity or issuer), and directors and senior executive officers (rather than all employees) of such entities.[12] We believe it is an improvement that sponsoring U.S. banking entities could include employees who are not directors or senior executive officers toward satisfying the "predominantly sold" condition and not have to track their investments, which often proved difficult as a practical matter. Despite this change, however, we recommend modifying this provision further to also exclude directors and senior executive officers from the "predominantly sold" condition entirely because the requirement to monitor the investments made by these individuals would continue to impose a substantial compliance burden because it continues to extend to senior officers and directors not only of the banking entity, but also of its affiliates. More generally, this ownership requirement should be eliminated because it creates an unwarranted discrepancy between FPFs and RICs—U.S. banking entities and their affiliates may own up to 25% of a RIC that it sponsors with no restriction placed on director or employee investment. Thus, this aspect of the Proposed Rule undermines the agencies' stated purpose to "more closely align the [FPF] provision with the exclusion for similarly-situated U.S. registered investment companies."[13]

Similarly, another area the Proposed Rule does not address is the disparity between FPFs and RICs created by the fact that a U.S. banking entity can own up to 25% of a RIC after the seeding period, but only 15% of a

"predominantly" through one or more public offerings outside the United States. Current Rule § _.10(c)(1). Public offering," in turn, is limited to a distribution of securities in "any jurisdiction outside the United States to investors, including retail investors, provided that: (A) [t]he distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; (B) [t]he distribution does not restrict availability to investors having a minimum level of net worth or net investment; and (C) [t]the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available." Current Rule § _.10(c)(1)(iii).

10 NPR at 12127.

11 NPR at 12127. The Proposed Rule only applies the condition that the distribution comply with all applicable requirements in the jurisdiction where it is made to instances in which the banking entity acts as the investment manager, investment adviser, commodity trading advisor, commodity pool operator or sponsor. NPR at 12127.

12 NPR at 12127.

13 NPR at 12123.

FPF that it sponsors after the seeding period. The outcome is inconsistent with the agencies' objective[14] of according similar treatment to FPFs and RICs and yet the agencies have not provided any justification for applying different standards to FPFs and RICs in this particular context. This arbitrary threshold for FPFs has caused challenges for banking entities in practice, particularly when seeding FPFs in smaller markets or where third-party investors in smaller FPFs have concentration concerns. More generally, this inconsistency also creates a competitive disadvantage for U.S. banking entities subject to the 15% ownership limitation. Similarly, there is no apparent justification for subjecting a foreign banking organization that wishes to use a U.S. affiliate (of which the FBO is neither a direct or indirect subsidiary) as a sponsor for a FPF for client- or commercial-related preferences to a post-seeding period 15% ownership limit—such a limit seems particularly arbitrary given the FBO could hold up to 25% of a FPF if no U.S. sponsor was involved. The agencies should, therefore, provide that a FPF would not be considered to be an affiliate of a banking entity so long as the banking entity owns less than 25% of the fund's interests after the permissible seeding period.[15]

B. The agencies should confirm that the customer facilitation vehicle exclusion would permit a third-party unaffiliated with the client (and not only a banking entity) to hold a *de minimis* ownership interest in the vehicle for corporate and administrative purposes.[16]

We support the agencies' creation of a new exclusion from the "covered fund" definition for certain customer facilitation vehicles that are formed by or at the request of a customer of a banking entity for the purpose of providing such customer (or one or more affiliates of such customer) with exposure to a transaction, investment strategy or other service provided by the banking entity.[17] Specifically, the Proposed Rule would allow a banking entity to rely on the proposed customer facilitation exclusion if a number of conditions are satisfied,[18] including, among other things,[19] all of the ownership interests of the vehicle are owned by the customer (or one or more of its affiliates) for whom the vehicle was created, other than up to 0.5% of the vehicle's outstanding ownership interests that may be held by the banking entity and its affiliates for the purpose of, and to the extent necessary for, establishing corporate separateness or addressing bankruptcy, insolvency or similar concerns.[20]

BPI believes the Proposed Rule's customer facilitation vehicle exclusion would afford banking entities greater flexibility to provide traditional commercial banking services in a vehicle to accommodate clients' objectives

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14 *See, e.g.*, NPR at 12126 ("In order to provide consistent treatment between U.S. registered investment companies and their foreign equivalents, the implementing regulations exclude foreign public funds from the definition of covered fund . . . Based on experience implementing the 2013 [Final Rule], as well as discussions with and comments received from regulated entities, it appears that some of the conditions of the foreign public fund exclusion may not be necessary to ensure consistent treatment of foreign public funds and registered investment companies. Moreover, some conditions may make it difficult for a non-U.S. fund to qualify for the exclusion or for a banking entity to validate whether a non-U.S. fund qualifies for the exclusion, resulting in certain non-U.S. funds that are similar to U.S. registered investment companies being treated as covered funds.").

15 *See also* the recommendation discussed in Section IV.C of this letter.

16 This section is responsive to Questions 60–63, 65 in the NPR.

17 NPR at 12140.

18 NPR at 12141–42.

19 Proposed Rule §_.10(c)(18)(ii)(B)(2) (Anti-bailout provisions); Proposed Rule § _.10(c)(18)(ii)(B)(3) (Prospective investor disclosures); Proposed Rule §_.10(c)(18)(ii)(B) (Material conflicts of interest provisions); Proposed Rule §_.10(c)(18)(ii)(B)(5) (Applying Section 23B of the Federal Reserve Act); Proposed Rule §_.10(c)(18)(ii)(B)(6) (Low-quality asset prohibition under Section 23A of the Federal Reserve Act).

20 Proposed Rule §_.10(c)(18)(ii)(B)(4).

and commercial preferences. We also appreciate the agencies' clarification that the exclusion's conditions are not meant to "preclude a banking entity from marketing its services through the use of customer facilitation vehicles or discussing with its customers prior to formation of the customer facilitation vehicle the potential benefits of structuring such services through a vehicle."[21] There is one further clarification, however, that we recommend the agencies make in order to adopt an exclusion that is factually representative of how client facilitation structures operate in practice. The agencies should specify that 0.5% of the ownership interests in the customer facilitation vehicle may be held by a third-party for corporate and administrative purposes. It is typical for third-party trustees and other similar service providers or their designees (rather than the banking entity itself) to hold a *de minimis* interest in client facilitation vehicles.

C. The family wealth management vehicle exclusion should be amended to (i) allow the ownership of non-trust vehicles to include up to 10 closely-related persons, (ii) clarify that any third-party unaffiliated with the family customers may hold a *de minimis* ownership interest in the vehicle for corporate and administrative purposes and (iii) expressly provide banking entities with the flexibility to tailor the investor disclosure obligations to the specific circumstances of each particular family wealth management vehicle.[22]

BPI supports the agencies' statement that an "exclusion for family wealth management vehicles would effectively tailor the definition of covered fund by permitting banking entities to continue to provide traditional banking and asset management services that do not involve the types of risks [the Volcker Rule] was designed to address."[23] Accordingly, we support the Proposed Rule's new exclusion for family wealth management vehicles that are issuers, within the meaning of the Investment Company Act of 1940,[24] that rely on Section 3(c)(1) or 3(c)(7) of the Act. These issuers are a valuable tool for many banking entities engaging in traditional asset management activities for clients seeking to achieve estate planning objectives and build individual and family wealth.

Under the Proposed Rule, a family wealth management vehicle must be an entity that is not, and does not hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities.[25] If the entity is a trust, then all of the grantor(s) of the trust must be family customers.[26] If the entity is not a trust, then (i) a majority of the voting interests in the entity must be owned, directly or indirectly, by family customers; and (ii) the entity must be owned solely by family customers and up to three closely related persons of the family customers.[27] As is the case with the proposed client facilitation vehicle exclusion, banking entities relying on the proposed family wealth management vehicle exclusion would also be required to comply with the Current Rule's anti-bailout, investor disclosure and prudential backstop requirements, Section 23A's low-quality assets prohibition and the 0.5% limitation on the ownership of a vehicle's outstanding ownership interests.[28]

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21 NPR at 12141.

22 This section is responsive to Questions 53, 57 in the NPR.

23 NPR at 12171.

24 15 U.S.C. 80a-1 et seq.

25 Proposed Rule §_.10(c)(17).

26 Proposed Rule §_.10(c)(17)(i)(A).

27 Proposed Rule §_.10(c)(17)(i)(B).

28 *See supra* note 19.

Although the conditions of the proposed exclusion generally align with the recommendations in BPI's 2018 Comment Letter, we believe that the agencies should reconsider the number of closely related persons that are allowed to hold ownership interests in non-trust entities. In our members' experience, clients frequently organize family wealth management vehicles with more than three closely related persons. We, therefore, recommend the agencies modify the proposed exclusion to allow up to ten closely related persons to invest in a qualifying family wealth management vehicle to ensure that vehicles that would otherwise satisfy every other condition of this exclusion are not prevented from doing so on account of too narrow of a limitation on ownership by closely related persons. Moreover, for reasons similar to the ones described above for client facilitation vehicles, we recommend the agencies expressly permit any party unaffiliated with a family customer to hold up to a 0.5% ownership interest in the family wealth management vehicle as it is oftentimes a trustee or similar service provider or their designee holding a *de minimis* interest for corporate and administrative purposes rather than the banking entity.

In addition, we recommend the agencies expressly reaffirm in an amended exclusion the guidance provided in the NPR[29] regarding banking entities having the flexibility to satisfy the written disclosure obligations in §_.11(a)(8) by tailoring such requirements based on the specific circumstances of family wealth customers and their respective vehicles. The agencies recognized that offering documents are oftentimes unnecessary in the family wealth management vehicle context[30] and, therefore, the exclusion itself should provide that the content, format and distribution of the investor disclosures may need to be modified on a case-by-case basis to accurately reflect a family wealth management vehicle's structure and purpose. For example, the agencies should expressly incorporate into the final exclusion guidance making clear that banking entities are not required to request that family customers amend their vehicles' governing documents to include the required disclosures and that firms may satisfy their disclosure delivery obligations by providing the disclosure to the banking entity's client (*i.e.*, the family wealth management vehicle).

D. The agencies should clarify that loan securitization exclusion's non-loan asset limit should be calculated relative to the original size of securitization's total collateral pool and the par value of the securities or assets on the day they are acquired.[31]

The Proposed Rule permits a loan securitization vehicle to hold up to 5% of its assets in non-loan assets, which amends the Current Rule's requirement that a loan securitization's assets be composed exclusively of loans and not include any securities or derivatives (subject to limited exceptions for cash equivalents and foreign exchange

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29 NPR at 12139, n. 164 ("The obligations under §.11(a)(8) of the proposed rule would apply in connection with the exemption for organizing and offering covered funds, which would typically require the preparation and distribution of offering documents. The agencies understand that offering documents may not be necessary in connection with most family wealth management vehicles given the vehicles' purpose and the requirement that interests in such vehicles be limited to family customers and up to 3 closely related persons of the family customers. Accordingly, the agencies believe that for purposes of the proposed exclusion, a banking entity could satisfy these written disclosure obligations in a number of ways, such as including them in the family wealth management vehicle's governing documents, in account opening materials or in supplementary materials. The condition reflects the agencies' interest in providing family customers with the substance of the disclosures, rather than a concern with the document in which they are provided. Similarly, the agencies expect the specific wording of the disclosures in §l.11(a)(8) of the proposed rule may need to be modified to accurately reflect the specific circumstances of the family wealth management vehicle.").

30 *Id.*

31 This section is responsive to Questions 13–16 in the NPR.

and interest rate derivatives).[32] The Proposed Rule also codifies the agencies' FAQs relating to the scope of permissible servicing assets not being limited to securities and the definition of qualifying "cash equivalents."[33]

BPI generally supports these changes to the loan securitization exclusion, but recommends the agencies clarify that the non-loan asset limit should be calculated relative to the original size of the securitization's total collateral pool—otherwise, normal amortization of, or prepayments within, the loan portion of the securitization portfolio could cause the remaining portion of non-loan assets to exceed the threshold of for the then-current asset pool, and subsequently disqualify the securitization from the exclusion. Moreover, we recommend the agencies specify that the non-asset loan limit should be calculated based on the par value of the relevant securities or assets on the day they are acquired as that reflects the methodology most commonly used among industry participants.

E. The safe harbor from the definition of "ownership interest" for certain senior loans and senior debt instruments should be clarified to address the effect of accelerated amortization in respect of fixed principal payments.[34]

We support the agencies' modifications to the Current Rule's definition of "ownership interest" to clarify that senior loans and senior debt instruments without economic features associated with equity do not constitute "ownership interests." The Proposed Rule provides a safe harbor for *bona fide* senior loan and senior debt interests that, among other characteristics, do not entitle the holders thereof to receive a share of the income, gains or profits of the covered fund, but rather only (i) interest at a stated interest rate, as well as commitment fees or other fees, which are not determined by reference to the performance of the underlying assets of the covered fund and (ii) fixed principal payments on or before a maturity date (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, foregone income resulting from an early prepayment).[35]

Although the proposed safe harbor would provide banking entities with "more clarity and predictability,"[36] we believe a further clarification is necessary to fully enable banking entities to "determine more readily whether an interest would be an ownership interest under the [Current Rule]."[37] Specifically, we propose the agencies confirm that any accelerated amortization provisions associated with a senior loan or senior debt interest would not prevent that instrument from meeting the fixed principal payment requirement.

F. We support the agencies' amendments to Super 23A to include the exemptions provided under Section 23A of the Federal Reserve Act and Regulation W for purposes of interpreting Super 23A, but recommend the agencies confirm that (i) the exemptions in Regulation W applicable to "securities affiliates" are available to covered funds in the Volcker Rule context, (ii) Regulation W's prohibition on the purchase of low-quality assets does not apply to transactions that banking entities facilitate as riskless principal for family wealth management

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32 Proposed Rule § _.10(c)(8)(i)(E); *see also* Current Rule § _.10(c)(8).

33 FAQ #4, *available at* https://www.federalreserve.gov/supervisionreg/faq.htm#4; *see* also NPR at 12128–29.

34 This section is responsive to Questions 80–81 in the NPR.

35 Proposed Rule § _.10(d)(6)(i)(B).

36 NPR at 12147.

37 NPR at 12147.

vehicles, and (iii) certain other ordinary extensions of credit to advised or sub-advised third-party covered funds are also exempt from Super 23A.[38, 39]

We support the agencies' proposal to incorporate the exemptions available under Section 23A of the Federal Reserve Act[40] ("**Section 23A**") and Regulation W[41] into Super 23A for certain transactions between a banking entity and a related fund that are not subject to Section 23A's quantitative limits, collateral requirements and low-quality asset prohibition, including (i) intraday extensions of credit (so long as the banking entity has safety and soundness policies designed to manage the risk exposure and only if the banking entity has no reason to believe the related fund cannot repay the credit; (ii) purchases of an extension of credit subject to a repurchase agreement; and (iii) transactions secured by cash or U.S. government securities.[42] These changes balance the objective of preventing banking entities from engaging in relationships with related funds that create a risk that the banking entities will "bail out" these funds,[43] while not restricting banking entities' provision of ordinary course transactions and services to custody clients that pose little to no risk to the banking entity, and are a natural and necessary aspect of traditional commercial banking-related activities. To enable banking entities to fully utilize the exemptions available under Section 23A and Regulation W, however, the agencies should confirm that for Super 23A purposes the limited number of exemptions, such as riskless principal transactions, [44] that permit banking entities to purchase a security from a "securities affiliate" (*i.e.*, a registered broker-dealer), such as riskless principal transactions,[45] are available to all related covered funds. This confirmation would not raise any anti-evasion concerns as banking entities would nevertheless be required to comply with the terms of the specific exemption (*e.g.*, in the case of a riskless principal transaction, that the security is not underwritten or sold as principal (other than as riskless principal) by any affiliate) as well as Regulation W's other built-in limits and protections, such as the restrictions regarding the purchase of low-quality assets. Accordingly, the agencies should confirm this interpretation in the amendments to the Current Rule to appropriately incorporate the exemptions under Section 23A and Regulation W into Super 23A. Moreover, the agencies should confirm that banking entities are permitted to engage in riskless principal transactions that involve purchases and sales of low-quality assets for purposes of Regulation W specifically in respect of transactions with family wealth management vehicles. In certain circumstances, a family client for whom the banking entity sponsors or advises a family wealth management vehicle may request that the banking entity, acting as a riskless principal, facilitate a sale of a low-quality asset to a third party as a result of structuring or other commercial preferences. Such transactions pose little to no market or credit risk to the banking entity while allowing it to provide a traditional asset management service to its family customers. We, therefore, recommend the agencies confirm that riskless principal

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38 This section is responsive to Questions 71, 73, 75 in the NPR.

39 The revisions to Super 23A requested herein would apply to any new covered fund exclusions that include a condition requiring compliance with Super 23A.

40 *See* 12 U.S.C. § 371c(d).

41 12 C.F.R. Part 223 (Subpart E).

42 NPR at 12143.

43 *See, e.g.*, 156 Cong. Reg. 5901 (daily ed. July 15, 2010) (statement of Sen. Merkley) ("[T]he intent of [Super 23A]" is "to prohibit banking entities from bailing out funds they manage, sponsor, or advise, as well as funds in which those funds invest[.]").

44 *See, e.g.*, 12 C.F.R. § 223.42(f) (Purchasing certain marketable securities), § 223.42(g) (Purchasing municipal securities); § 223.42(m) (Riskless principal transactions).

45 *Id.*

transactions for family wealth management vehicles involving purchases and sales of low-quality assets are exempt from Regulation W's low-quality asset prohibitions.[46]

We also support the agencies' proposal to include in an amended Super 23A certain exemptions for a banking entity's short-term extensions of credit to, and purchases of assets from, a related fund, including an extension of credit or purchase of assets made in the ordinary course of business in connection with payment transactions, securities, derivatives, or futures clearing, or settlement services.[47] These proposed changes would provide banking entities greater flexibility to engage in ordinary course, temporary transactions with related funds that do not raise the type of safety and soundness concerns Congress intended to address with Super 23A.[48] The agencies should also expressly confirm in the preamble to the amended regulations that ACH transactions (whether executed on a credit or pre-funded basis) would qualify for the proposed short-term credit extension exemption.

We would further encourage the agencies to consider exempting from the Super 23A prohibition certain other ordinary extensions of credit by a banking entity to a covered fund provided the banking entity does not organize and offer the covered fund or retain an ownership interest in the covered fund. These extensions of credit might include ordinary extensions of credit within the quantitative and qualitative limits under Regulation W (or other appropriate limits) or extensions of credit to covered funds to which the banking entity only serves as co- or sub-advisor. We do not believe that these types of ordinary extensions of credit to an advised or managed covered fund, subject to appropriate limits, would increase risk to banking entities or create incentives to bail-out the covered fund.

III. Adoption of Certain Proposed Rule Provisions as Proposed

We support the agencies' adoption of the following provisions as proposed in the NPR.

A. We agree with the agencies' proposed rule of construction on parallel investments and co-investments with covered funds.[49]

The agencies should adopt the proposed rule of construction concerning a banking entity's parallel investments and co-investments with covered funds, which would clarify that a banking entity may make such investments in any amount so long as they comply with applicable laws and regulations, including applicable safety and soundness standards.[50] We do not believe this rule of construction would increase the risk of evasion as banking entities would still, for example, be prohibited from engaging in impermissible proprietary trading and required to comply with the Current Rule's anti-bailout restrictions applicable to a banking entity's organized and offered covered funds and the prudential backstop safeguards of the Current Rule.[51]

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46 For purposes of consistency, the agencies should also clarify that banking entities are permitted to engage in riskless principal transactions for client facilitation vehicles that involve the purchase and sale of low-quality assets without violating the requirements of 12 C.F.R. § 223.15(a).

47 NPR at 12144–45.

48 *See*, *e.g.*, 156 Cong. Reg. 5901 (daily ed. July 15, 2010) (statement of Sen. Merkley) ("[T]he intent of [Super 23A]" is "to prohibit banking entities from bailing out funds they manage, sponsor, or advise, as well as funds in which those funds invest[.]").

49 This section is responsive to Questions 83–84.

50 Proposed Rule §§ _.12(b)(5).

51 *See* Current Rule §§ _.11, _.15.

B. We support the agencies' clarification that CRA-qualified investments and permissible public welfare investments under other applicable regulations are excluded from the covered funds restrictions.[52]

The agencies request comment as to whether the public welfare investment fund exclusion should be clarified to exclude from the covered funds restriction all permissible public welfare investments under any agency's regulations.[53] To eliminate any uncertainty as to the Volcker Rule treatment of permissible public welfare investments, including CRA-qualified investments, we support the inclusion of clarifying language in an amended version of the Current Rule that the existing exclusion extends to any permissible public welfare investments under any agency's regulations.

C. We welcome the agencies' proposed codification of the guidance related to qualifying foreign excluded funds in amendments to the Current Rule.[54]

The Proposed Rule codifies the staffs' guidance in respect of qualifying excluded funds and thereby makes permanent the temporary relief from the definition of "banking entity" the agencies had previously extended to qualifying foreign excluded funds (**"FEFs"**).[55] Consistent with the agencies' views,[56] we believe that this proposed change would limit the extraterritorial application of the Volcker Rule in accordance with principles of international comity and minimize disruption of foreign banking entities' ability to conduct asset management operations outside the United States.

D. We support the agencies' proposed revisions to the exclusion for small business investment companies to account for their entire life cycle, including SBICs' wind-down phase.[57]

The Proposed Rule would revise the exclusion for SBICs to specify that it "applies to an issuer that was an SBIC that has voluntarily surrendered its license to operate as a small business investment company in accordance with [the Small Business Administration's regulations] and does not make new investments (other than investments in cash equivalents) after such voluntary surrender."[58] This clarification would allow banking entities to more freely

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52 This section is responsive to Question 20 in the NPR.

53 NPR at 12130.

54 This section is responsive to Question 1–3 in the NPR.

55 Proposed Rule §§ _.6(f), _.13(d); *see, e.g.*, Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf; *see* Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 17, 2019), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190717a1.pdf.

56 NPR at 12125 ("Exempting the activities of these foreign funds would also allow their foreign banking entity sponsors to continue to conduct their asset management business outside the United States as long as the foreign banking entity's acquisition of an ownership interest in or sponsorship of the fund meets the requirements in section __.13(b). Thus, the proposed exemption may have the effect of promoting the safety and soundness of these foreign funds and their sponsors, while at the same time limiting the extraterritorial impact of the implementing regulations, consistent with the purposes of section 13(d)(1)(H) and (I) of the BHC Act").

57 This section is responsive to Question 23 in the NPR.

58 NPR at 12131.

invest in issuers that are SBICs without the concern that the issuer may become a covered fund during its wind-down phase for reasons outside the banking entity's control.

IV. Additional Issues

We also support the following recommendations in respect of the Current Rule or the Proposed Rule, as applicable:

A. The agencies should revise the "banking entity" definition to exclude public welfare and community development funds (including those engaged in CRA-qualified investments) and employees' securities companies.

As discussed in BPI's 2018 Comment Letter, we believe that certain categories of entities, such as public welfare and community development investment and similar funds (including those engaged in CRA-qualified investments)[59] and employees' securities companies ("**ESCs**"), would be unduly restricted, without any meaningful policy benefit, if treated as "banking entities" and should, therefore, be expressly excluded from the definition of "banking entity" in any amendment to the Volcker Rule regulations. For example, limited partnership investments in public welfare and community development investment funds, such as affordable housing partnerships, are held under a separate authority and are therefore not provided an exclusion from the definition of "banking entity." Similar to investments held under the merchant banking authority, these funds are often managed by third-party sponsors over which banks have no practical control, making the application of the Volcker Rule's compliance requirements to these funds challenging, if not impossible. Moreover, treating public welfare and community development investment and similar funds as banking entities could unnecessarily limit the types of activities in which they can engage, which, in turn, may have a negative impact on the causes and communities they serve.

For similar reasons, ESCs should also be expressly excluded from the "banking entity" definition. The agencies noted in the 2018 NPR that ESCs are "controlled by their sponsors and, if those sponsors are banking entities, may themselves be treated as banking entities . . . [which] may conflict with [ESCs'] stated investment objectives."[60] To the extent that an ESC invests in a covered fund, its investment would be for the purpose of providing the sponsoring banking entity's employees with incentive compensation, and would not give the sponsoring banking entity exposure to the fund. Treating ESCs as banking entities would unnecessarily restrict the types of investments these entities can make without furthering any meaningful policy objective.

We, therefore, again urge the agencies to revise the Current Rule to exclude funds, such as public welfare and community development investment and similar funds and ESCs, as described above. As an alternative to providing express exclusions for these categories of funds from the "banking entity" definition, the agencies could also exempt them from both the proprietary trading and covered fund restrictions. However the agencies choose to implement these changes, the amendments should permit banking entities to use corporate structures to make investments and establish relationships that are important from a strategic or risk management perspective, as well as facilitate client or employee investments, without imposing the costs and burdens of Volcker Rule compliance on these structures. Moreover, these proposed revisions are consistent with the language and purpose of the statute, and the agencies have the authority to implement these modifications to the Current Rule.[61]

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59 *See* Current Rule § _.10(c)(11) (small business investment companies and public welfare investment funds exclusion).

60 2018 NPR at 33446.

61 *See* 12 U.S.C. § 1851(d)(1)(J).

B. The agencies should adopt an exclusion for a banking entity's *bona fide* erroneous acquisition or retention of an ownership interest in a covered fund, consistent with the Current Rule's exclusion for error trades in the proprietary trading context.

Similar to the error trades exclusion from the proprietary trading prohibition,[62] the agencies should adopt an exclusion for erroneous acquisitions or retention of ownership interests in covered funds and related correcting transactions from the prohibition on banking entities holding as principal an ownership interest in a covered fund. As with error trades, banking entities should have the flexibility in the covered funds context to fix *bona fide* errors in the course of conducting a permitted or excluded activity by entering into subsequent transactions as principal to deliver on a customer's intended structure or original request.

C. The agencies should expressly codify the previous staff guidance regarding the seeding period for RICs and FPFs in an amendment to the Current Rule.[63]

Through the issuance of two FAQs, the agencies addressed certain questions regarding whether RICs or FPFs could potentially be treated as banking entities due to a sponsoring banking entity having "control" over these funds through its seeding period investment, which would result in these RICs and FPFs being subject to the Current Rule's restrictions on proprietary trading and covered fund investments in a way that could interfere with their businesses. The 2018 NPR confirmed the guidance in FAQs #14 and #16 that RICs and FPFs should not be treated as a "banking entity" subject to the Volcker Rule's proprietary trading restrictions during the seeding period and that a three-year seeding period is an example of, and not a maximum length, of a permissible seeding period.[64] We would strongly request that the agencies codify this guidance in the amendments to the Current Rule and also expressly confirm that this includes seeding by third parties, such as authorized participants of exchange traded funds.

D. The agencies should extend the investment limit and capital deduction relief provided for ownership interests in third-party covered funds held as permissible underwriting or market-making positions to such positions held in sponsored or advised covered funds.

Pursuant to the 2019 Amendments, the Current Rule no longer requires banking entities include in the 3% aggregate funds limit or Tier 1 capital deduction calculations the value of ownership interests in third-party covered funds held in a permissible underwriting or market-making capacity.[65] These requirements should also be eliminated

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62 *See* Current Rule § __.3(d)(10).

63 This section is responsive to Question 13 in the NPR.

64 *See* 2018 NPR at 33443. In FAQ #14, the staffs addressed the "banking entity" status of FPFs sponsored by a banking entity, stating that they would not advise that the activities and investments of an excluded FPF be attributed to the sponsoring banking entity for purposes of the Volcker Rule so long as "the banking entity does not own, control or hold with the power to vote 25 percent or more of any class of voting shares of the fund (after the seeding period), and provides investment advisory, commodity trading, advisory, administrative and other services to the fund in compliance with applicable limitations in the relevant foreign jurisdiction." Federal Reserve, Volcker Rule Frequently Asked Questions (last updated Mar. 4, 2016), *available at* https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#14.

FAQ #16 addressed the treatment of FPFs and RICs during seeding periods, stating that the staffs would neither advise the agencies to treat a FPF or RIC as a banking entity solely on the basis of the level of ownership of the FPF or RIC by a banking entity during a seeding period of "for example, three years," nor "expect an application to the Board to determine the length of the seeding period." Federal Reserve, Volcker Rule Frequently Asked Questions (last updated Mar. 4, 2016), *available at* https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#16.

65 *See* Current Rule § __.11(c).

with respect to underwriting and market-making positions held by banking entities in sponsored or advised covered funds. Doing so would not expose banking entities to greater risk because ownership interests acquired in such funds pursuant to the exemptions for underwriting and market-making related activities would remain subject to the restrictions contained in those exemptions. Further, the banking entity would not be unduly exposed to the risks of the covered fund as it would still need to comply with the covered transactions restrictions set forth in Super 23A and the market terms requirements of Section 23B. Not only would extending the funds limit and capital charge relief to sponsored and advised funds reduce compliance burdens and allow banking entities to provide greater market liquidity in its sponsored and advised covered funds, but it would also more closely align the Current Rule with Section 13 of the BHC Act. As the agencies observed in the 2019 Amendments, the statute "does not require any per-fund or aggregate limits, or capital deduction, with respect to covered fund ownership interests acquired pursuant to the underwriting and market making exemption in [S]ection 13(d)(1)(b)."[66] For these reasons, the agencies should revise the Current Rule to provide that banking entities need not include permissible underwriting or market-making positions in sponsored or advised funds in their investment limits and capital deduction calculations.

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[66] 84 Fed. Reg. at 62017.

BPI appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by phone at 646-736-3960 or by email at gregg.rozansky@bpi.com.

Respectfully submitted,

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