INVESTMENT COMPANY INSTITUTE®

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April 1, 2020

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

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

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R–1696; RIN 7100–AF70

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

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

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

Dear Sirs and Mesdames:

The Investment Company Institute[1] appreciates the opportunity to comment on the proposal ("Proposal") issued by the above-listed agencies ("Agencies") to amend the regulations

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$24.1 trillion in the United States, serving more

("Implementing Regulations") implementing Section 13 of the Bank Holding Company Act, commonly known as the Volcker Rule.[2]

ICI and its members welcome the Agencies' continuing efforts to "provide greater clarity and certainty about what activities are [and are not] prohibited" by the Implementing Regulations.[3] For several years, we have urged the Agencies to ensure that the Implementing Regulations do not place unnecessary constraints on US registered investment companies ("RICs") and similar funds organized outside the United States (collectively, "regulated funds")—funds to which the Volcker Rule was never intended to apply. Our recommendations largely have focused on two areas: the potential treatment of a regulated fund as a "banking entity" subject to the prohibitions and restrictions of the Volcker Rule, and the scope of the exclusion for "foreign public funds" ("FPFs") from the definition of "covered fund."

In this letter, we briefly discuss the extent to which the Proposal would address our longstanding concerns in the areas identified above. We recommend that the Agencies include specific language in the preamble to any final rule that would provide our members with more certainty about regulated fund seeding practices. We express strong support for the proposed revisions to the FPF exclusion and urge the Agencies to finalize them promptly.

Regulated funds and the definition of "banking entity"

Since the development of the Implementing Regulations, the Agencies have been aware that the broad definition of "banking entity" and its interplay with the definition of "covered fund" create some uncertainty as to whether a regulated fund, particularly during its seeding period, could be treated as a banking entity.[4] ICI and other stakeholders repeatedly have urged the Agencies to make changes to the Implementing Regulations to resolve this uncertainty. We have explained at length why treating a regulated fund as a banking entity would be inconsistent with Congressional intent underlying the Volcker Rule and at odds with the nature of regulated funds as collective investment vehicles for the general public.[5]

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than 100 million US shareholders, and US$7.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 12120 (Feb. 28, 2020).

[3] Proposal at 12122.

[4] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846, 68856 (Nov. 7, 2011) (text accompanying n.81; questions 6 and 8).

[5] *See, e.g.*, Letter to the Agencies from ICI, dated Oct. 17, 2018 (ICI 2018 Letter), available at https://www.ici.org/pdf/31448a.pdf; Letter to the OCC from ICI, dated Sept. 21, 2017 (responding to the OCC's request for public input on how the Implementing Regulations may be improved), available at https://www.ici.org/pdf/30882a.pdf; Letter to the Honorable Janet Yellen, Chair, The Federal Reserve System, from Paul Schott Stevens, President & CEO, ICI, dated June 1, 2015.

ICI and its members appreciate the efforts that the Agencies and their staffs have made to understand these concerns and address them. Notably, in FAQs issued shortly before the Volcker Rule effective date in July 2015, the staffs provided assurance that a banking entity would be able to own a significant portion of the shares of a RIC or FPF during a multi-year "seeding period" in which the banking entity is testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes and attempting to distribute the fund's shares. The staffs also provided assurances that FPFs would not be considered banking entities under the Implementing Regulations solely because they may have corporate governance structures that differ from those of RICs.

In the preamble to the June 2018 proposal to amend the Implementing Regulations,[6] the Agencies described in detail the clarifications provided by the staff FAQs. In particular, they noted that the staffs chose not to set a maximum prescribed period for a RIC or FPF seeding period. The Agencies stated that their review of these issues was ongoing, and the preamble posed several questions about the treatment of regulated funds under the Implementing Regulations, the guidance provided in the FAQs, and other approaches the Agencies could take to address the issues. The Agencies confirmed that nothing in the 2018 Proposal would modify the application of the staff FAQs. They then adopted the staffs' position as their own, stating:

> the Agencies will not treat RICs or FPFs that meet the conditions included in the applicable staff FAQs as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs.[7]

The preamble to the Proposal observes that the Agencies' prior request for comment asked about "the effectiveness of the guidance provided" in these FAQs.[8] The preamble then states, without further elaboration, that "the proposed rule would not modify or revoke any previously issued staff FAQs, unless otherwise specified."[9]

The Agencies appear to have concluded that the FAQs are operating effectively (adopting the FAQ positions as the Agencies' interpretation of the Implementing Regulations) and that other approaches, including revision of the Implementing Regulations, are not necessary. While we welcome this continuing endorsement of the guidance provided by the FAQs, the Agencies can and should provide greater clarity regarding regulated fund seeding practices through discussion in the preamble to any final rule. Doing so would be consistent with the Agencies' stated intent to provide banking entities with greater clarity and certainty about what activities are permitted. We accordingly recommend that the Agencies include in the preamble to any final rule the following statement, which closely tracks language in the preamble to the 2018 Proposal:

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[6] *See* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33432 (July 17, 2018) ("2018 Proposal").

[7] 2018 Proposal at 33444.

[8] Proposal at 12122-23.

[9] Proposal at 12123.

> Nothing in this final rule will modify or revoke the guidance provided in the staff FAQs that relate to RICs and FPFs. Further, the Agencies will not treat RICs or FPFs that meet the conditions included in the applicable staff FAQs as banking entities or attribute their activities or investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs and described by the Agencies in the 2018 proposal to amend the regulations implementing the Volcker Rule.[10]

The Agencies also should consider including language in the preamble to any final rule regarding a banking entity's provision of seed capital to a third-party RIC or FPF organized as an exchange-traded fund ("ETF"). Although such seeding may not fall neatly within the contours of the staff FAQs, it should be treated as a permissible activity for Volcker Rule purposes. The banking entity, in its capacity as an "authorized participant" to the ETF, is purchasing and holding fund shares as the fund works to establish regular trading and liquidity on the secondary market. As ICI explained during development of the Implementing Regulations, this is market making activity to support an investment product that Congress intended to be outside the scope of the Volcker Rule.[11]

Scope of the "foreign public fund" exclusion

The Implementing Regulations appropriately exclude "foreign public funds" from the definition of "covered fund." The stated objective of this exclusion is "to treat foreign public funds consistent with similar US funds and to limit the extraterritorial impact of [the Volcker Rule], including by permitting US banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States." As ICI and its members have explained on several occasions, however, the Agencies crafted the exclusion more narrowly than necessary to achieve their regulatory goals by requiring that:

(1) a non-US fund be authorized to offer and sell ownership interests to retail investors in its home jurisdiction;

(2) ownership interests in the fund be sold predominantly through one or more public offerings outside of the United States; and

(3) ownership interests in a non-US fund sponsored by a US banking entity be sold predominantly to unaffiliated parties.

For the reasons detailed in the ICI 2018 Letter, these three conditions of the FPF exclusion have made it more difficult for asset management affiliates of US banking entities to offer retail investment vehicles in the same manner and to the same extent as their peers in foreign banking

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[10] This discussion can be found in Section III.A.1.a of the 2018 Proposal, at 33442-44.

[11] Letter to the Agencies from ICI, dated Feb. 13, 2012, available at https://www.ici.org/pdf/25909.pdf.

organizations and firms unaffiliated with banks. These competitive disadvantages are certainly not what Congress intended in adopting the Volcker Rule.

We therefore appreciate the Agencies' willingness to revisit the contours of the "foreign public fund" exclusion based on their and banking entities' experience with the Implementing Regulations. We also welcome their recognition 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."[12]

The Proposal calls for replacing the first two conditions outlined above with a requirement that the fund is authorized to offer and sell ownership interests, and such interests are offered and sold, through one or more public offerings. It also would require a "public offering" to be a distribution that is subject to substantive disclosure and retail investor protection laws or regulations.

ICI strongly supports this approach. The fact that a fund is offered and sold publicly in one or more jurisdictions outside the United States should provide sufficient assurance that the fund is adhering to the regulatory requirements necessary to offer and sell its shares to the general investing public, as determined by the local regulator in such jurisdiction(s). Further, the proposed requirement that the distribution be subject to substantive disclosure and retail investor protection laws or regulations will provide added assurance that the fund being distributed is sufficiently similar to a RIC.[13] As we previously have explained, these laws and regulations vary across jurisdictions but are guided by common principles for public investment funds that have been developed by the International Organization of Securities Commissions ("IOSCO"). The 127 jurisdictions that are IOSCO members regulate more than 95 percent of the world's securities markets, including all the major emerging markets, and they commit to do so according to these common principles and the more detailed IOSCO policy work that informs the principles. Given this level of commonality, it is not necessary for the Agencies to identify particular laws or regulations that would meet this requirement or otherwise specify features of "substantive disclosure and retail investor protection laws or regulations."[14]

The Proposal also would revise the current limitation on sales to affiliated parties by not restricting sales of fund shares to employees (other than senior executive officers) of the fund, its sponsoring banking entity and any affiliates. In other words, the Proposal would require shares of the FPF to be sold predominantly to persons other than directors or senior executive officers of the fund, its sponsoring banking entity, and their affiliates. While helpful, we believe that this

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[12] Proposal at 12126.

[13] The Proposal does not go as far as ICI recommended to achieve parity in treatment as between RICs and FPFs. Specifically, the FPF exclusion would not be available to a non-US fund that does not offer its shares publicly, while the corresponding exclusion in the Implementing Regulations for RICs places no conditions on their distribution. *See, e.g.*, ICI 2018 Letter (explaining that a banking entity sponsor may use a regulated non-US fund to form part of a larger portfolio for certain clients who want the protections afforded by a regulated fund).

[14] This discussion is responsive to question 8. *See* Proposal at 12127.

limitation remains unnecessarily more stringent than the requirements applicable to RICs. ICI believes that greater parity between RICs and FPFs would be achieved by considering this condition satisfied if at least 75 percent of the non-US fund's ownership interests are sold to persons other than the fund, its sponsoring banking entity, and their affiliates.[15]

Taken together, the proposed changes to the "foreign public fund" exclusion largely address the concerns we outlined in the ICI 2018 Letter and should help "to more closely align the provision with the exclusion for similarly-situated U.S. registered investment companies."[16]

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We appreciate this opportunity to share the views of the regulated fund industry regarding needed improvements to the Implementing Regulations. If you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5813 or solson@ici.org; Rachel H. Graham, Associate General Counsel, at (202) 326-5819 or rgraham@ici.org; or Frances M. Stadler, Associate General Counsel and Corporate Secretary, at (202) 326-5822 or frances@ici.org.

Sincerely,

/s/ Susan M. Olson

Susan M. Olson
General Counsel
Investment Company Institute

[15] This discussion is responsive to question 11. *See id.* at 12128.

[16] Proposal at 12123.