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Statement on Volcker Rule Covered Funds Proposal  
By Governor Lael Brainard

The purpose of the Volcker rule is to limit banks' exposure to speculative trading activity and risky funds so they do not again put taxpayer funds at risk. I have previously supported exempting community banks from the Volcker rule, and I support today's proposal to address the inadvertent treatment of foreign funds as banking entities under the Volcker rule. However, I am concerned that several of the proposed changes will weaken core protections in the Volcker rule and enable banking firms again to engage in high-risk activities related to covered funds.

The proposal opens the door for firms to invest without limit in venture capital funds and credit funds.<sup>1</sup> The proposal suggests that these funds do not raise concerns about banks' involvement in risky activity that the Volcker rule was intended to address. To the contrary, it is clear why Congress legislated the Volcker rule to limit these activities.

Some credit funds played a material role in the financial crisis. These funds were not transparent in their activities, misled investors, and contributed to the financial abuses Congress intended to address in passing the Dodd-Frank Act.

Venture capital funds are a type of private equity fund. As such, they pose similar risks. The agencies determined in 2013 that excluding venture capital funds from the definition of covered funds is not supported by the statutory language. I don't see the basis for excluding venture capital funds. The proposal also asks whether to carve out from the Volcker rule's

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<sup>1</sup> These are funds that may be leveraged and invest in debt instruments.

restrictions on private equity funds those private equity funds that pursue a long-term investment strategy. Such an exclusion would be inconsistent with the statute.

Congress put in place strong protections around these types of funds to mitigate the risks posed by hedge funds and private equity funds. I see no change in the statute or in the nature of these activities that would call for weakening those protections.

With regard to congressional intent, it is notable that Congress amended the Volcker rule two years ago and chose not to make any of today's proposed changes. Congress chose not to add an exclusion for venture capital funds, credit funds, family wealth funds, or customer facilitation funds or to expand any of the existing exclusions.

Finally, pursuant to the 2013 rule, the regulators were clear that a banking entity could not evade the Volcker rule's fund investment limits by creating a "synthetic" interest in a sponsored covered fund. This was intended to address the risk that a bank making side investments alongside a sponsored fund—and telling fund investors about this side investment—would have strong incentives to "bail out" the fund if it got into trouble. Today's proposal would reverse that restriction. Not only would today's proposal give banking firms the green light to exclude parallel investments from the statutory limits on covered fund investments, but it would also explicitly allow them to market the covered fund on the basis of the parallel investments.

For these reasons, I do not support the proposal.

I am supportive of the proposal to address the unintended application of the Volcker rule to certain funds organized outside of the United States and offered to foreign investors, known as foreign excluded funds. While these funds are not "covered funds" under the rule, if they are controlled by a foreign banking entity, they have been found to be subject to the rule as "banking entities" in certain circumstances. Given the limited nexus to the United States, it is appropriate

to exempt them, consistent with the “no-action” relief currently provided by the banking agencies.

I appreciate all the work that has gone into today’s proposal, and I look forward to public comments.