

**Meeting between Federal Reserve Board Staff
and Representatives of National Australia Bank
May 13, 2011**

Participants: Mark Cahaney, David Krasnostein, and Jay Son Yoong (National Australia Bank); H. Rodgin Cohen, Jiang Liu, Virgil Mattingly, and Mark Menting (Sullivan & Cromwell)

Betsey Howes-Bean, Brian Knestout, David Lynch, Jeremy Newell, Kathleen O’Day, and Christopher Paridon (Federal Reserve Board)

Summary: Staff of the Federal Reserve Board met with representatives of National Australia Bank (“NAB”) to discuss the restrictions on proprietary trading and hedge fund and private equity fund activities under section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (also known as the “Volcker Rule”).

Among matters discussed in the meeting were NAB’s views regarding: the potential impact of the Volcker Rule on NAB’s investment advisory and asset management business; scope of statutory exemptions related to insurance company activities and activities of foreign-based banking entities “solely outside of the United States”; potential scope of the statutory definition of “hedge fund” and “private equity fund”, as well as “banking entity,” under the Volcker Rule; and the potential impact of the Volcker Rule on foreign-based banking entities and the U.S. financial system.

Attachment¹

¹ This summary has been updated to include the attached information.

Applicability of the Volcker Rule to the Wealth Management Business of National Australia Bank Limited

Introduction

This outline is being provided to the staff of the Board of Governors of the Federal Reserve System (the “**Federal Reserve**”) on behalf of National Australia Bank Limited (“**NAB**”) and its wealth management division MLC (“**MLC**”).

This outline explains our view that the sponsorship by MLC of certain Australian trusts (the MLC Funds discussed below) and their investments, directly and through pooling trusts (the “**Pooling Trusts**”) ¹, in private equity and hedge funds are not prohibited by the so-called “Volcker Rule,” Section 13 of the Bank Holding Company Act of 1956, as amended (the “**BHC Act**”), as added by the Dodd-Frank Wall Street Reform and Consumer Protection Act. This outline also explains that the investments by MLC Limited (“**MLCL**”), an Australian registered life insurance subsidiary of NAB, in private equity and hedge funds with proceeds from the issuance of investment-linked life insurance and traditional life insurance policies are also not prohibited by the Volcker Rule.

Executive Summary

NAB is one of Australia’s largest financial institutions and is an authorized deposit-taking institution in Australia under the Banking Act 1959 (Cth). NAB and its subsidiaries are subject to the BHC Act and its restrictions on nonbanking activities for two separate reasons. First, NAB is a bank holding company because of its ownership of a U.S. subsidiary bank, South Dakota-based Great Western Bank. Second, NAB is a “foreign banking organization” because it has a branch in New York.

MLC carries on substantial wealth management activities. MLC manages approximately A\$116 billion on behalf of individual and corporate customers. MLC’s customers invest through MLC in three principal ways: (i) through MLC superannuation funds, (ii) through MLC non-superannuation funds (together with the MLC superannuation funds, the “**MLC Funds**”) and (iii) through life insurance policies issued by MLCL. MLCL is regulated by the Australian Prudential Regulation Authority (“**APRA**”).

“Superannuation” is an Australian pension scheme under which employers make compulsory contributions to superannuation funds on behalf of their employees. The employees may also make voluntary contributions to the superannuation funds. Currently, MLC manages 12 superannuation funds, which are offered to Australian residents only.

¹ The Pooling Trusts, as discussed below, are used as a means of pooling together assets from a variety of MLC sources in order to achieve investment diversification, efficiencies and scale, ultimately in pursuit of the investment objectives of each fund.

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In addition to the retirement savings-related superannuation funds, MLC also manages approximately 90 non-superannuation funds, which are offered to Australian and New Zealand residents only.

The legal structure of each of the MLC Funds is an Australian trust. One or more MLC companies serve as trustee (each, a “**MLC Trustee Company**”) to each of the MLC Funds. For the MLC superannuation funds, the MLC Trustee Company, acting as trustee for the funds, invests on behalf of its MLC customers, (i) directly, (ii) through the Pooling Trusts, or (iii) through investment-linked life insurance policies issued by MLCL, in a variety of assets, which include private equity and hedge funds. For the MLC non-superannuation funds, the MLC Trustee Company, acting as trustee for the funds, invests on behalf of its MLC customers, through the Pooling Trusts, in a variety of assets, which include private equity and hedge funds. Each of the Pooling Trusts is also an Australian trust, with a MLC Trustee Company serving as trustee.

In addition to the MLC superannuation funds, individuals and other entities also purchase a variety of traditional life insurance policies and investment-linked life insurance policies issued by MLCL. Premiums received by MLCL from the issuance of investment-linked life insurance policies and traditional life insurance policies are allocated to the so-called “statutory funds” established by MLCL on its books as required by Australian law for the benefit of the MLCL policyholders as more fully described below in Section III below.

We believe that the sponsorship by MLC of the MLC Funds and the Pooling Trusts is permissible under the Volcker Rule for a number of reasons.

First, because the MLC Funds and the Pooling Trusts do not rely on either the Section 3(c)(1) or 3(c)(7) exemption under the Investment Company Act of 1940 (the “**Investment Company Act**”), the MLC Funds and the Pooling Trusts are not private equity funds or hedge funds as defined under the Volcker Rule.

Second, the MLC Funds and the Pooling Trusts should not be deemed to be “similar funds” under the Volcker Rule because the MLC Funds and the Pooling Trusts do not have the characteristics of a traditional private equity fund or hedge fund.

Third, even if MLC Funds and the Pooling Trusts were deemed to be private equity funds or hedge funds for purposes of the Volcker Rule, MLC’s sponsorship of the MLC Funds and the Pooling Trusts is permissible under Section 13(d)(1)(I) of the BHC Act because the MLC Funds and Pooling Trusts are not offered for sale or sold to any U.S. resident and the sponsorship activities are conducted pursuant to Section 4(c)(9) of the BHC Act and occur solely outside of the United States.

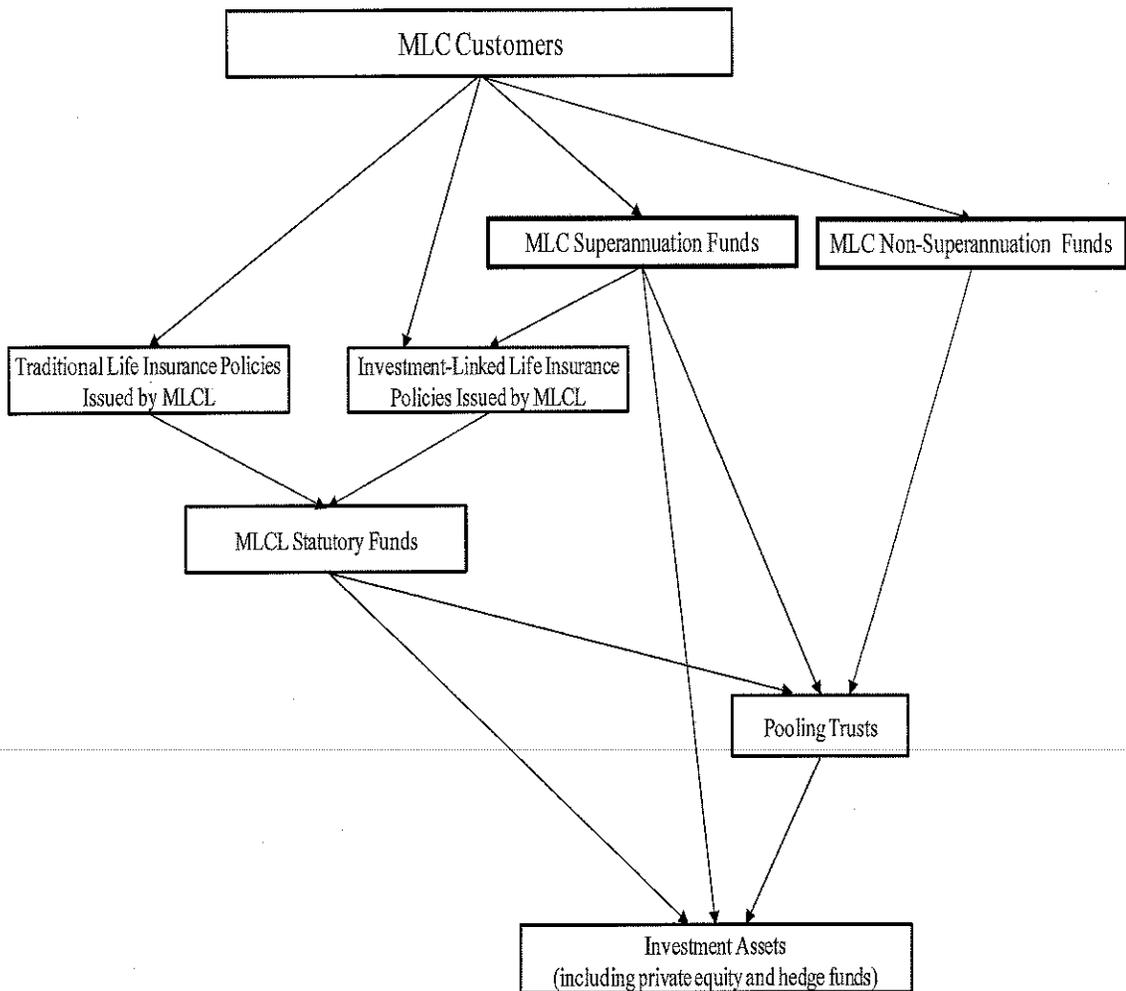
If the MLC Funds and the Pooling Trusts were deemed to be banking entities for purposes of the Volcker Rule because a MLC Trustee Company serves as trustee to the MLC Funds and the Pooling Trusts, we believe that the investments in private equity funds and hedge funds by the MLC Funds are permissible under Section 13(d)(1)(D) of the BHC Act because such activities are on behalf of customers.

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The investments in private equity and hedge funds by the Pooling Trusts are also permissible because they are either on behalf of customers or derived from insurance general account funds.

MLCL is an insurance subsidiary of NAB and, therefore, a banking entity for purposes of the Volcker Rule. The investments in private equity and hedge funds made by MLCL's "statutory funds" are permissible under the Volcker Rule because such activities are either on behalf of customers or for the general account of MLCL.

Set forth below is a diagram of MLC's wealth management business.



Set forth below is a more detailed description of MLC's wealth management business and the related legal analysis.

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I. MLC's Superannuation Business²

1. Overview. Superannuation is a pension scheme in Australia under which employers are required by the Superannuation Industry (Supervision) Act of 1993 (the "**Superannuation Act**") to make compulsory contributions to superannuation funds on behalf of their employees. The employees may also make voluntary contributions to the superannuation funds. The superannuation contributions are invested over the period of the employees' working life and can be accessed when the employees retire.
2. Offering of superannuation funds. The offering of superannuation funds in Australia is regulated pursuant to the Superannuation Act and subject to prudential regulatory oversight by the APRA. The Superannuation Act is the primary legislation for the regulation of superannuation funds in Australia, performing a function analogous to ERISA with respect to U.S. pension funds. Participation in superannuation funds is limited to Australian residents only. Superannuation vehicles are generally established in the form of trusts with an APRA-regulated trustee entity responsible for the management and investment of the superannuation fund.
3. MLC trustee company. Currently, MLC sponsors and manages 12 superannuation funds. The legal form of each MLC superannuation fund is an Australian trust. A MLC Trustee Company serves as trustee to each of the 12 superannuation funds. The MLC Trustee Company offers investments in MLC superannuation funds to the public through superannuation offering documents, which generally contain a product guide, an application form and an investment menu. Such superannuation offering documents are required by the Corporations Act 2001 (Cth) (the "**Corporations Act**"). In addition, each of the MLC Trustee Companies is licensed and supervised by APRA and each of the MLC superannuation funds is registered with, and supervised and examined by, APRA.
4. No investment by MLC. Neither MLC nor any of its affiliates uses proprietary money to seed, or make any investment in, any of the MLC superannuation funds and they do not hold any equity interest in such funds.

² In March 2009, NAB submitted a draft request (the "**Fiduciary Exemption Submission**") for a determination from the Federal Reserve that, when MLCL makes investments using superannuation-sourced funds either directly or indirectly through a MLC trust, MLCL and/or a MLC trustee (as applicable) may rely on the fiduciary exemption provided under Section 4(c)(4) of the BHC Act. Since March 2009, NAB has made two submissions in response to questions of the Federal Reserve staff on the Fiduciary Exemption Submission.

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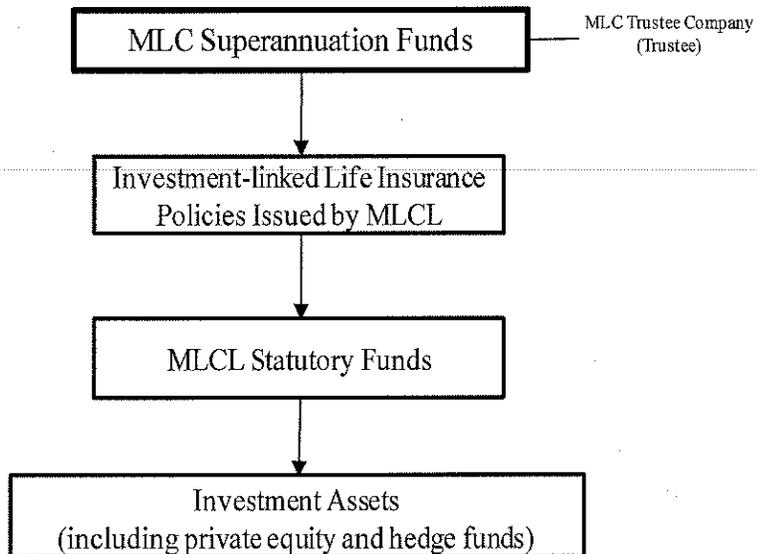
5. Assets not recorded on books of NAB/MLC. The assets of the MLC superannuation funds are not recorded on the books of NAB/MLC.³ MLC receives management and/or administration fees for its services to the MLC superannuation funds, the amount of which is based on the amount of assets under management and not based on the performance of the investments.
6. Member's account. When an Australian resident becomes a member of a MLC superannuation fund, an account is established on behalf of the member (or the beneficiary thereof). The superannuation funds offered by MLC are "account-based" as opposed to "interest-based." In other words, a member's account with a superannuation fund offered by MLC represents the member's beneficial interest in various assets that the member has instructed the MLC Trustee Company to invest in (and that are held in trust), and the value of a member's account equals the sum of those assets. Because different members may and do instruct MLC Trustee Company to invest in different assets, an account with a superannuation fund does not represent a fractional undivided interest in the overall assets of that fund. For this reason, the MLC superannuation funds do not issue any unit certificates of the trusts to their members.
7. Account management. When money is paid into a MLC superannuation fund member's account, a MLC Trustee Company invests the money, directly or indirectly through the Pooling Trusts, in shares, debt securities, property, government securities, investment-linked life insurance policies, private equity funds and hedge funds. The member receives an annual statement reflecting the value of the member's account, which is the sum of all the investments held in the account (including cash). The content of the statement and the timing of its delivery are governed by the Superannuation Act. The value of the account is based on the fair market value of the investments held through the account as described below.
8. Investments. Three of the MLC superannuation funds invest monies received from members of such funds in investment-linked life insurance policies issued by MLCL as more fully described below. MLC's other nine superannuation funds invest either directly, or through the Pooling Trusts, in assets such as shares, debt securities, property, government securities, private equity funds and hedge funds as more fully described below.

³ To the extent the MLC superannuation funds purchase insurance policies issued by MLCL, the premiums received by MLCL for the issuance of such policies are recorded on the books of MLCL as described in Section III.1.

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- (i) Investment-linked life insurance policies as an investment vehicle. Each of the three MLC superannuation funds that invest in investment-linked life insurance policies has a single umbrella investment-linked life insurance policy issued by MLCL with the MLC Trustee Company named as the policyholder on behalf of the members of the fund. This policy provides no death benefit coverage. Monies received by these three superannuation funds in member accounts are aggregated on a daily basis to purchase units of the investment-linked life insurance policy. The monies invested in these investment-linked life insurance policies issued by MLCL are required by applicable Australian law to be maintained by MLCL in separate “statutory funds.” The value of a member’s account in these statutory funds is a product of the number of units allocated to such member under the investment-linked life insurance policy and the price of those units. The unit price reflects the performance of the underlying assets (purchased by MLCL using the monies in the statutory funds as described in Section III below), less fees, expenses and taxes. MLCL calculates the unit price daily. A member can access current account information online. Set forth below is a diagram of the structure of a MLC superannuation fund investment through a MLCL investment-linked life insurance policy (the “**MLCL Insurance Policy Structure**”). Please see Annex A for the rationale and background of the MLCL Insurance Policy Structure.

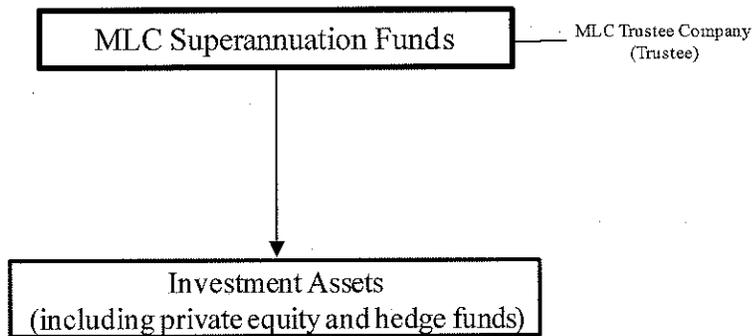
MLCL Insurance Policy Structure



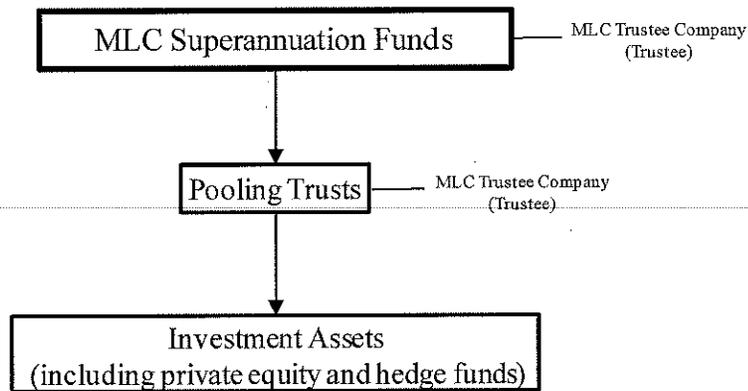
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- (ii) Direct investments (the “Direct Structure”) and indirect investments through the Pooling Trusts (the “Pooling Trust Structure”). MLC’s other superannuation funds (*i.e.*, other than the three that invest in investment-linked life insurance policies issued by MLCL) invest either directly, or through the Pooling Trusts, in assets such as shares, debt securities, property, government securities, private equity funds and hedge funds, as directed by individual members. A MLC Trustee Company serves as trustee to the Pooling Trusts. Set forth below are diagrams of the structures of a MLC superannuation fund investment through the Direct Structure and the Pooling Trust Structure.

Direct Structure



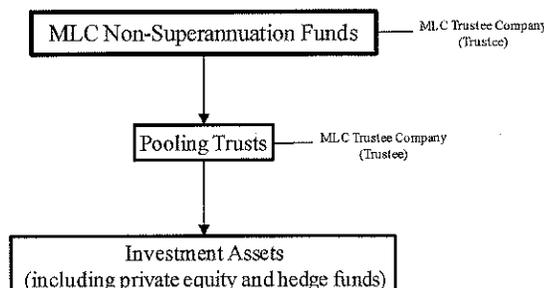
Pooling Trust Structure



II. MLC's Non-Superannuation Business

1. Overview. In addition to its retirement savings-related MLC superannuation business, MLC also has non-superannuation investment vehicles. Currently, MLC manages approximately 90 non-superannuation funds. The legal form of each MLC non-superannuation fund is an Australian trust. Similar to the MLC superannuation fund structure, a MLC Trustee Company serves as trustee to each of the MLC non-superannuation funds. The MLC Trustee Company offers investments in MLC non-superannuation funds to Australian and New Zealand residents only.
2. No investment by MLC. Neither MLC nor any of its affiliates uses proprietary money to seed, or make any investment in, any of the MLC non-superannuation funds and they do not hold any equity interest in such funds.
3. Assets not recorded on books of NAB/MLC. The assets of the MLC non-superannuation funds are not recorded on the books of NAB/MLC. MLC receives management and/or administration fees, the amount of which is based on the amount of assets under management and not based on the performance of the investments.
4. Member's interests. When an Australian or New Zealand resident becomes a member of a MLC non-superannuation fund, an account is established on behalf of the member (or the beneficiary thereof). The non-superannuation funds offered by MLC are "interest-based." A member's investment in a non-superannuation fund is represented by "interests" in the trust measured in terms of units. The price of these units is updated daily. For U.S. law purposes, those units would be securities.
5. Investments. The monies received by the MLC non-superannuation funds are invested, through the Pooling Trusts, in assets such as shares, debt securities, property, government securities, private equity funds and hedge funds. Set forth below is a diagram of the structure of a MLC non-superannuation fund investment through the Pooling Trust Structure.

Pooling Trust Structure



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III. MLCL's Statutory Funds

As described in Section I above, three MLC superannuation funds invest through the purchase of investment-linked life insurance policies issued by MLCL. In addition, individuals and other entities may purchase investment-linked life insurance as well as a variety of traditional life insurance policies issued by MLCL. Premiums received by MLCL from the investment-linked life insurance policies and traditional life insurance policies are allocated to the so-called "statutory funds" established by MLCL as required by Australian law. This section of the outline explains the ultimate allocation and investment of monies derived from the issuance of these policies, which flow through the statutory funds.

1. Assets recorded on books of MLC. For an Australian insurer such as MLCL, statutory fund assets are owned by the insurer and appear on the insurer's balance sheet. This is because a statutory fund is not a separate legal entity from the life insurance company and the assets of the statutory fund remain the assets of the insurer. In addition, the applicable accounting standard issued by the Australian Accounting Standards Board, AASB 1038 (Section 5.1), expressly states that a life insurance company "must recognise in its financial report the assets, liabilities, revenue, expenses and equity of the entity, whether they are designated as relating to policyholders or to shareholders."
2. Statutory Fund Requirement. The Life Insurance Act 1995 (Cth) (the "Life Act") requires that all life insurance companies "must at all times have at least one statutory fund in respect of its life insurance business but may have more statutory funds if it chooses to do so" with premiums received from policyholders to support the future claims of the life insurance policies. In addition, Section 31 of the Life Act provides that "a life company that carries on life insurance business consisting of the provision of investment-linked benefits must maintain a statutory fund or statutory funds exclusively for that business so far as it is carried on in Australia." Statutory funds are a device established only in the records of the company and relate only to the life insurance business of the company. Statutory funds are not legal entities, notwithstanding the use of the term "fund."
3. Five Statutory Funds. MLCL has established five statutory funds relating to different classes of its life insurance business that hold customer funds derived from the investment-linked and traditional life insurance policies. The premiums received by MLCL from its policyholders (three MLC superannuation funds and individuals and other entities described above) are allocated among the following five statutory funds as follows:
 - (iii) Statutory Fund No. 1 – traditional life insurance policies.
Policyholders are MLCL individual customers.

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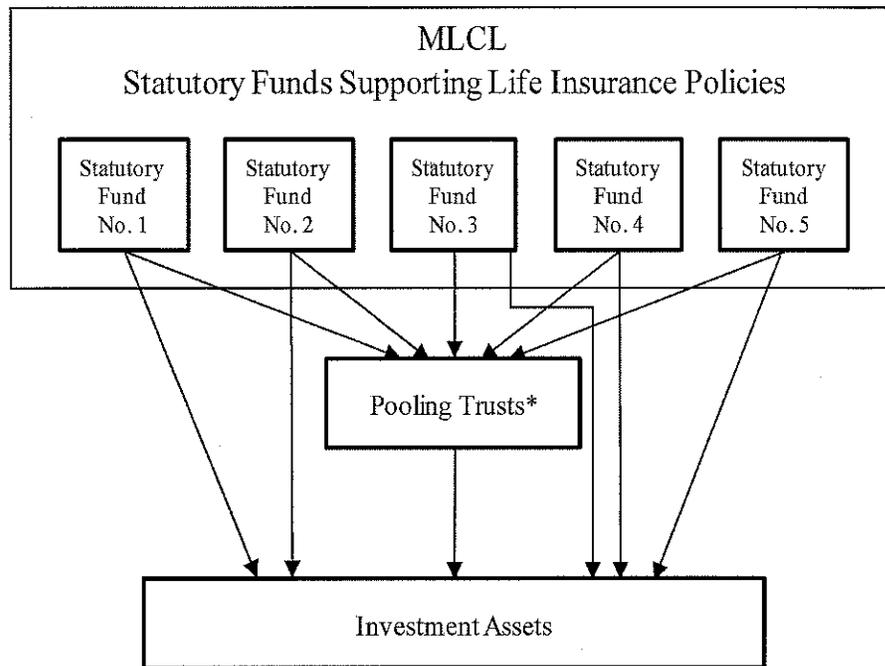
- (iv) Statutory Fund No. 2 – investment-linked life insurance policies. Policyholders are MLC trustees acting on behalf of investors in the MLC superannuation funds and, to a lesser extent, certain individuals and third-party entities.
- (v) Statutory Fund No. 3 – investment-linked life insurance policies. Policyholders are individuals and third-party entities.
- (vi) Statutory Fund No. 4 – investment-linked life insurance policies. Policyholders are MLC trustees acting on behalf of investors in the MLC superannuation funds and, to a lesser extent, certain individuals and third-party entities.
- (vii) Statutory Fund No. 5 – whole life, endowment (a life insurance contract designed to pay a lump sum after a specified term (on its “maturity”) or on earlier death) and pure endowment policies (a life insurance contract that promises to pay the insured value in case the holder survives a certain fixed period), as well as insurance policies providing a death benefit plus some type of identifiable savings account or investment account. Policyholders are individuals and third-party entities.

4. Sub-accounts of statutory funds. Each MLCL statutory fund has two sub-accounts: (i) a policyholder’s account which includes the amounts invested with policyholder funds and (ii) an ordinary account which represents (a) MLCL’s asset management fees and (b) MLCL’s regulatory capital. MLCL is expressly required by the Life Act to maintain regulatory capital in each statutory fund. The purpose of the regulatory capital is to protect policyholders in the event that, for example, there is an operational error. Generally, regulatory capital is not used to compensate policyholders in respect of investment losses. The amount of regulatory capital required to be maintained by MLCL in a statutory fund is determined by applicable APRA policies and accounting standards. For statutory funds No. 2, No. 3 and No. 4, the amount of regulatory capital is approximately 1% of the aggregate value of each of the statutory funds. For statutory fund No. 1, the amount of regulatory capital is approximately 6% of the aggregate value of the statutory fund. For statutory fund No. 5, the amount of regulatory capital is less than 1% of the aggregate value of the statutory fund. MLC has no proprietary investments in any of the statutory funds other than the required regulatory capital.

The management fees component of the ordinary account is invested, separately from the assets in the policyholder’s account, in cash and short-term securities until it is distributed, on an annual basis, to MLCL as fees. In order to maintain the required regulatory capital level in the five statutory funds, the regulatory capital component of the ordinary account is invested together with the assets in the policyholder’s account.

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5. Direct investments and indirect investments through the Pooling Trusts. The statutory funds invest either directly, or through the Pooling Trusts, in assets such as shares, debt securities, property, government securities, private equity funds and hedge funds. Set forth below is a diagram of the structure of the statutory funds of MLCL.



* The Pooling Trusts also pool assets from the MLC Funds.

6. Asset management fees.
- (i) For statutory funds No. 2, No. 3 and No. 4, MLCL charges asset management fees on investments made through these statutory funds (which are not directly based on MLCL's performance). These fees accrue and are transferred out of the policyholder's account of each of the relevant statutory funds to the ordinary account of the statutory fund, on a daily basis.
 - (ii) For statutory funds No. 1 and No. 5, MLCL does not charge any asset management fees. Rather, because the "risk" on the assets in these statutory funds is borne by MLCL, the asset management fees paid out to external managers is simply a cost to MLCL. What MLCL retains is the profits after deducting costs (including such asset management fees and policy claims) from the premium income.

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7. Income.

- (i) For MLCL's investment-linked life insurance policies as to which the premiums are invested in statutory funds No. 2, No. 3 and No. 4, the income, gains and losses of the policyholder's account inure directly to, and the investment risk is borne by, the policyholders. The rate of return of an investment-linked life insurance policy is tied to the performance of the policyholder's account assets. Investment performance is not guaranteed by MLCL. Charges relating to policy administration and investment management are deducted from the policyholder's account and held in the ordinary account (until transferred to MLCL as discussed above).
- (ii) For MLCL's traditional life insurance policies as to which the premiums are invested in statutory funds No. 1 and No. 5, the income, gains and losses of the policyholder's account inure directly to, and the investment risk is borne by, MLCL. This is because the traditional life insurance policies typically provide for guaranteed benefits.

8. Right to withdraw/surrender.

- (i) For MLCL's investment-linked life insurance policies as to which the premiums are invested in statutory funds No. 2, No. 3 and No. 4, the policyholders have the right to surrender their policies and withdraw the cash value of their participation in the policies, in whole or in part, which results in MLCL liquidating the underlying invested assets at market value.
- (ii) For MLCL's traditional life insurance policies as to which the premiums are invested in statutory funds No. 1 and No. 5, such policies can be cancelled upon request by the policyholders or due to non-payment of premiums.

9. Not subject to MLCL's credit risk. The assets held in any one of MLCL's statutory funds are insulated from claims of all other creditors, including creditors of other statutory funds, so that if MLCL becomes insolvent, the assets of the statutory funds are required by the Life Act to be distributed to policyholders before any distribution is made to MLCL's creditors and MLCL's shareholders.

10. Investment restrictions. For an Australian insurer such as MLCL, Section 43 of the Life Act provides that a life company may invest statutory fund assets in any way that is likely to further the business of the statutory fund. A life insurance company may not invest more than 2.5% of the total value of the statutory funds in shares of a related company that

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is listed. All of MLCL's statutory funds are subject to the same investment restrictions and limitations under the Life Act.

11. Assets are to be separately managed. For an Australian insurer such as MLCL, pursuant to Section 34(3) of the Life Act, the insurer is required to keep the assets of each statutory fund separate and distinct from other statutory funds or other assets. The fees payable by the statutory fund that accrue to the ordinary account may only be transferred to MLC once:
 - (i) the statutory capital adequacy requirements in respect of the statutory fund (which are assessed on an annual basis) are met; and
 - (ii) the expenses of the statutory fund (*e.g.*, MLCL's employee remuneration, third-party investment manager fees, etc.) are paid.
12. Duties. The Insurance Contracts Act (Cth) 1984 imposes a duty of utmost good faith on a life insurance company in relation to its dealings with policyholders and their investments. In addition, Section 48 of the Life Act requires directors of a life insurance company to use reasonable care and due diligence to ensure that the life insurance company complies with the Life Act in the investment, administration and management of the statutory fund assets.

IV. The Volcker Rule Prohibitions and Certain Exemptions

1. The Volcker Rule generally prohibits a banking entity from, among other things, sponsoring or investing in hedge funds and private equity funds, subject to certain exceptions or permitted activities.
2. Under the Volcker Rule, a private equity fund or a hedge fund is an issuer that would be an investment company, as defined in the Investment Company Act, but for Section 3(c)(1) or 3(c)(7) of that Act,⁴ or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission (the "SEC"), and the Commodity Futures Trading Commission may determine.
3. There are a number of "permitted activities" that constitute exemptions from the broad hedge fund and private equity fund-related prohibitions of the Volcker Rule. Some of the relevant permitted activities include:

⁴ These are the principal exclusions from the definition of investment company that are relied upon by hedge funds and private equity funds, which generally exclude privately offered issuers (i) with one hundred investors or fewer or (ii) whose securities are acquired exclusively by "qualified purchasers" (generally, natural persons with \$5 million in investments and institutions with \$25 million in investments).

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- (i) “The acquisition or retention of any equity, partnership, or other ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity pursuant to paragraph (9) or (13) of Section 4(c) solely outside of the United States, provided that no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident 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.”
 - (ii) “The purchase, sale, acquisition, or disposition of securities and other instruments . . . on behalf of customers.”
 - (iii) “The purchase, sale, acquisition, or disposition of securities and other instruments . . . 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, provided that such activities by any affiliate are solely for the general account of the regulated insurance company, . . .”
4. Congress included in the final legislation specific direction that requires the Financial Stability Oversight Council (the “FSOC”) to put forth recommendations to “ . . . 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.” The FSOC published recommendations pursuant to this requirement in January 2011 (the “FSOC Study”).
5. Internal corporate structures should not be deemed private equity or hedge funds, according to a colloquy by Congressman Jim Himes of Connecticut and House Banking Committee Chairman Barney Frank of Massachusetts. House Banking Chairman Frank said that Congressman Himes was “absolutely correct” when the Congressman said:

“Madam Speaker, I rise to enter into a colloquy with Chairman Frank. I want to clarify a couple of important issues under Section 619 of the bill, the Volcker Rule.

The bill would prohibit firms from investing in traditional private equity funds and hedge funds. Because the bill uses the very broad Investment Company Act approach to define private equity and hedge funds, it could technically apply to lots of corporate structures, and not just the hedge funds and private equity funds.

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I want to confirm that when firms own or control subsidiaries or joint ventures that are used to hold other investments, that the Volcker Rule won't deem those things to be private equity or hedge funds and disrupt the way the firms structure their normal investment holdings."

This is known as the "Himes Colloquy."

6. Congress did not intend to have the Volcker Rule cover certain funds that are technically "hedge funds" and "private equity funds" but are not within the intended prohibitions of the Volcker Rule. In this regard, the FSOC Study provides that "[i]n implementing the Volcker Rule, Agencies should consider criteria for providing exceptions with respect to certain funds that are technically within the scope of the "hedge fund" and "private equity fund" definition in the Volcker Rule but that Congress may not have intended to capture in enacting the statute."

V. The Volcker Rule Analysis.

1. At issue here are the following:
 - (i) Whether the MLC Funds and the Pooling Trusts are private equity funds or hedge funds and therefore may not be sponsored by MLC;
 - (ii) Whether the investments in private equity funds or hedge funds made by the MLC Funds and the Pooling Trusts are prohibited by the Volcker Rule; and
 - (iii) Whether MLCL's statutory fund investments in private equity funds or hedge funds are prohibited by the Volcker Rule.
2. MLC's sponsorship of the MLC Funds and the Pooling Trusts is not prohibited by the Volcker Rule.
 - (i) Because the MLC Funds and the Pooling Trusts, which are Australian trusts, make no public offerings within the United States and are offered to Australian and New Zealand residents only, such funds are not required to register under the Investment Company Act. Because the MLC Funds and the Pooling Trusts do not rely on either the Section 3(c)(1) or 3(c)(7) exemption under the Investment Company Act, the MLC Funds and the Pooling Trusts are not private equity funds or hedge funds as defined under the Volcker Rule. MLC is not therefore prohibited by the Volcker Rule from sponsoring these MLC Funds and the Pooling Trusts.
 - (ii) The MLC Funds should not be deemed to be "similar funds" under the Volcker Rule because the term "similar funds" should be

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construed to encompass funds that are functionally similar to traditional hedge funds or private equity funds.

- (a) The MLC Funds are quite distinguishable from the hedge funds and private equity funds intended to be covered by the Volcker Rule. They are all publicly offered pursuant to offer documents required by statute. The MLC Funds are generally similar to registered mutual funds in the U.S. which are clearly not hedge funds or private equity funds for purposes of the Volcker Rule. In addition, the MLC superannuation funds are regulated by, and registered with, the APRA, as U.S. mutual funds are regulated by the SEC.
- (b) In the FSOC Study, when discussing which funds should be brought within the scope of the Volcker Rule as “similar funds,” the FSOC stated that “Agencies should consider the investment activities and other characteristics of such funds, including:
- ***Related compensation structure:*** Does the fund earn an allocation based on fund performance including both realized and unrealized gains?
 - ***Trading/Investment strategy:*** What trading or investment strategy does the fund utilize?
 - ***Use of leverage:*** Does the fund borrow or otherwise utilize material leverage for the purpose of increasing investment performance?
 - ***Investor composition:*** Is the fund’s capital received from a broad group of unaffiliated investors?”

An analysis of each of these factors provides strong support for the conclusion that the MLC Funds should not be deemed to be “similar funds.” None of the MLC Funds charges performance fees, although when MLC affiliates serve as investment managers they may receive performance-based fees. A majority of the MLC Funds do not use leverage. The MLC Funds are broadly diversified, investing in a variety of assets, including life insurance policies, shares, debt securities, property, government securities, private equity funds and hedge funds, principally with a medium- to long-term investment horizon. The MLC Funds are established as wealth management vehicles for millions of Australian and New Zealand residents,

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generally not as private funds offered to a limited group of sophisticated investors.

- (iii) The Pooling Trusts should also not be deemed to be “similar funds” under the Volcker Rule. Just like the MLC Funds, the Pooling Trusts are quite distinguishable from the hedge funds and private equity funds intended to be covered by the Volcker Rule. First, the Pooling Trusts’ direct “investors” are (i) MLCL’s statutory funds for the benefit of MLCL’s policyholders and (ii) the MLC Funds for the benefit of MLC’s customers. Second, the Pooling Trusts are created to organize the investment activities of the MLC Funds and the MLCL statutory funds in connection with certain types of investments and, therefore, are the types of internal corporate structures covered by the Himes Colloquy.
- (iv) Even if the MLC Funds and the Pooling Trusts were deemed to be private equity funds or hedge funds for purposes of the Volcker Rule, Section 13(d)(1)(I) of the BHC Act permits the sponsorship of a private equity fund or a hedge fund by a banking entity pursuant to Section 4(c)(9) of the BHC Act solely outside of the United States. This exemption would exempt the sponsorship of the MLC Funds and the Pooling Trusts by MLC if they met the following four conditions:
 - (a) the sponsorship of the MLC Funds and the Pooling Trusts is made pursuant to Section 4(c)(9) of the BHC Act;
 - (b) the sponsorship of the MLC Funds and the Pooling Trusts are “solely outside of the United States”;
 - (c) no ownership interest in the MLC Funds and the Pooling Trusts is “offered for sale or sold to a resident of the United States”; and
 - (d) the MLC Trusts and the Pooling Trusts are 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.

The sponsorship of the MLC Funds and the Pooling Trusts clearly meets all four conditions. With respect to the first, MLC is a division of NAB, a qualifying foreign banking organization (“QFBO”), more than half of NAB’s worldwide business is banking (disregarding its United States banking) and more than half of its banking business is outside the United States. With respect to the second, MLC does not engage in any of these activities from an office in the United States. In addition, all decisions for MLC to serve as trustee to a MLC Fund or Pooling

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Trust are made in Australia. With respect to the third, participation in the MLC Funds and the Pooling Trusts is limited to Australian and New Zealand residents only. With respect to the fourth, the MLC Funds and the Pooling Trusts are 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.

The exemption pursuant to Section 13(d)(1)(I) of the BHC Act does not have any geographic restrictions in terms of the investment activities conducted by such a private equity fund or hedge fund (*e.g.*, the MLC Funds and the Pooling Trusts). As a result, the investments made by the MLC Funds and the Pooling Trusts in private equity funds and hedge funds in the United States should not cause the sponsorship of the MLC Funds and the Pooling Trusts to be treated as not solely outside of the United States.

The permissibility of the investments made by the MLC Funds and the Pooling Trusts in private equity funds and hedge funds is discussed in the section below.

3. Direct investments in private equity and hedge funds by the MLC Funds and the Pooling Trusts.

The direct investments in private equity and hedge funds made by the MLC Funds and the Pooling Trusts are permissible under the Volcker Rule.

- (i) As noted, each of the MLC Funds and the Pooling Trusts is an Australian trust and a MLC Trustee Company serves as trustee for each of them. Each MLC Trustee Company has strict fiduciary duties to the trust beneficiaries under Australian law.
- (ii) MLC has no proprietary interest in the MLC Funds because neither MLC nor any of its affiliates uses proprietary money to seed, or make any investment in, any of the MLC Funds. As a result, the investments (including investments in private equity funds and hedge funds) made by the trustee to the MLC Funds are all for the benefit of members of such funds, in other words, “on behalf of customers,” and therefore such investments should be exempt from the Volcker Rule under Section 13(d)(1)(D) of the BHC Act.
- (iii) As described above, MLCL is required by the Life Act to maintain regulatory capital in each statutory fund. This capital could flow into the Pooling Trusts. As discussed in footnote 6 below, the investments made by the statutory funds are permissible under the Volcker Rule because they are either on behalf of customers or for

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the general account of MLCL. As a result, the investments made by the Pooling Trusts should also be permissible as the investments are made using either general account funds or customer funds.

4. Investments in private equity and hedge funds by MLCL's statutory funds No. 1 and No. 5.⁵

Any investments made by statutory funds No. 1 and No. 5 in private equity funds and hedge funds should be permissible under the Volcker Rule pursuant to Section 13(d)(1)(F) of the BHC Act, which provides an exemption (the "**Insurance General Account Exemption**") for investments by a regulated insurance company or its affiliates for the general account of the insurance company if:

- (i) the investment is conducted "in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State *or jurisdiction* in which each such insurance company is domiciled"; and
- (ii) the Federal banking agencies have not jointly determined that a particular law, regulation, or written guidance referred to above is insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States.

We note that the reference, in Section 13(d)(1)(F)(i), to compliance with "insurance company investment laws, regulations, and written guidance of the State *or jurisdiction* in which each such insurance company is domiciled" provides for non-U.S. insurers to be treated on the same footing as U.S. insurers. The phrase "or jurisdiction" makes no reference to the U.S. As a result, the investments in private equity funds and hedge funds made by a regulated non-U.S. insurer should be permissible pursuant to the Insurance General Account Exemption if the above conditions are met.

The investments made by statutory funds No. 1 and No. 5 meet all of these conditions for exemption under Section 13(d)(1)(F).

- (i) First, MLCL is an Australian registered life insurance company regulated by the APRA.

⁵ MLCL's statutory funds should not be deemed to be investment companies because they are not separate legal entities, but merely a bookkeeping mechanism established in the records of MLCL. Even if the statutory funds were deemed to be legal entities, because the statutory funds make no public offerings within the United States and are not offered to U.S. residents, they would not be required to register under the Investment Company Act, would not rely on either the Section 3(c)(1) or 3(c)(7) exemption under the Act, and therefore should not be deemed to be private equity funds or hedge funds as defined under the Volcker Rule.

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- (ii) Second, the investments made by statutory funds No. 1 and No. 5 are general account investments.
 - (a) For a U.S. insurer, a “general account” refers to the combined or aggregate investments and other assets of such insurance company available to pay claims and benefits to which policyholders are entitled. The general account may also be considered everything that is not represented by separate accounts of the insurance company. Policyholders are generally subject to the credit risk of the insurance company.
 - (b) The assets in statutory funds No. 1 and No. 5 are general account assets notwithstanding that they are segregated in a statutory fund. The only meaningful difference is that the assets in these funds have been effectively pledged to support the required payments for the traditional life insurance policies issued by MLCL, the proceeds of which are allocated to those funds in the event of an insolvency of MLCL. Otherwise the income, gains and losses of the policyholder’s accounts inure directly to, and the investment risk is borne by, MLCL. In the event the assets in the statutory funds are insufficient to pay the required payments on the relevant policies, MLCL would still be obligated to pay the remainder. Similarly, if the assets exceeded the required payments the overage would inure to the benefit of MLCL.
- (iii) Third, the investments made by statutory funds No. 1 and No. 5 are conducted in compliance with, and subject to, the investment restrictions and limitations under the Life Act.
- (iv) Fourth, the Federal banking agencies have not jointly determined that the Life Act is insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States. We believe it is highly unlikely that the Federal banking agencies would ever make such a determination.

- 5. Investments in private equity and hedge funds by MLCL’s statutory funds No. 2, No. 3 and No. 4.

The investments made by MLCL’s statutory funds No. 2, No. 3 and No. 4 in private equity funds and hedge funds should not be prohibited by the

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Volcker Rule because they are “on behalf of customers” as is the case with U.S. insurer separate account investments.⁶

- (i) Congressional intent. As discussed above, Congress intended to accommodate insurance company investment activities and the Volcker Rule requires the FSOC to put forth recommendations to “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.” In this regard, the FSOC Study includes a discussion of separate accounts of insurance companies, which, similar to the statutory funds No. 2, No. 3 and No. 4, are investment funding mechanisms that are legally segregated for the benefit of particular policyholders/customers. With respect to whether investments of separate accounts should be considered a permitted activity under the Volcker Rule, the FSOC Study recommends that the federal banking agencies “should consider how insurance companies invest separately on behalf of customers.”

The following factors all suggest that separate accounts, and, therefore statutory funds No. 2, No. 3 and No. 4 qualify as “on behalf of customers” and thereby accommodate ordinary course insurance activities.

- (a) Not a separate legal entity. A U.S. insurer’s separate account is established on the books of the insurer pursuant to state law to fund certain types of variable and certain other insurance contracts and must be kept separate from its general account and any other separate accounts it may maintain. The policyholders can choose among investment options provided by the insurer.
- (b) Investment risks borne solely by policyholders. While a U.S. insurer’s separate account assets are on the books of the insurer, the investment income, gains and losses of the

⁶ Under Australian law, MLCL is required to maintain regulatory capital in respect of each statutory fund. As discussed in Section III.4 above, the regulatory capital component represents only a *de minimis* amount for each of the statutory funds. We do not believe that the regulatory capital requirement should change the conclusion that the investments made by statutory funds No. 2, No. 3 and No. 4 are on behalf of customers because of the *de minimis* amount involved and the fact that it is there because of an express statutory requirement intended to protect customers. In any event, such assets should be considered general account assets and, therefore, the related investments should be permissible under the Volcker Rule pursuant to Section 13(d)(1)(F) of the BHC Act.

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separate accounts inure directly to, and the investment risk is borne by, the policyholders.

- (c) Subject to investment restrictions and insurance regulations. A U.S. insurer's separate account is subject to state insurance laws and the investment guidelines and restrictions of the applicable insurance contracts.
- (d) Right to withdraw. A contract supported by a separate account typically gives the policyholder the right to withdraw the cash value of the policy, in whole or in part, which results in the insurer liquidating the underlying invested assets at market value.
- (e) Not subject to insurer's credit risk. The assets held in the separate accounts are insulated from claims of other creditors of the insurer so that if the insurer becomes insolvent, the policyholders have a first priority claim on these assets.
- (f) Duties to policyholders. A U.S. insurer is required to invest and reinvest for its separate account, in good faith and with the degree of care that an ordinarily prudent person in a like position would use under similar circumstances.

All the above features of separate account investments of U.S. insurers are indicia of investments made on behalf of customers, which should be exempt from the Volcker Rule under Section 13(d)(1)(D) of the BHC Act. Indeed, although a U.S. insurer's separate account assets are on the books of the insurer, the investment income, gains and losses of the separate accounts inure directly to, and the investment risk is borne by, the policyholders. In addition, the principle of competitive equality dictates that the same exceptions would apply to non-U.S. companies that meet the same or substantially similar requirements.

Set forth below is a comparison of certain characteristics of U.S. insurer separate accounts and MLCL's statutory funds No. 2, No. 3 and No. 4. Because MLCL's statutory funds No. 2, No. 3 and No. 4 are substantially similar to U.S. insurer separate account, the investments in private equity and hedge funds by MLCL's statutory funds No. 2, No. 3 and No. 4 should be permissible as being on behalf of customers under Section 13(d)(1)(D) of the BHC Act.

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	U.S. Insurers' Separate Accounts⁷	MLCL Statutory Funds No. 2, No. 3 and No. 4
Structure	Not a separate legal entity.	Same.
Purpose	A U.S. insurer's separate account is established on the books of the insurer pursuant to state law to fund certain types of variable and certain other insurance contracts and is required to be maintained separate from other assets and accounts. The policyholders can choose the investment options provided by the insurer.	Same.
Assets	Assets recorded on books of insured.	Same.
Income/Losses	The investment income, gains and losses of the separate accounts inure directly to, and the investment risk is borne by, the policyholders.	Same. ⁸
Investment Restrictions	Subject to investment restrictions and insurance regulations.	Same.
Right to Withdraw	Policyholder may withdraw cash value of the policy.	Same.
Insurer's Credit Risk	Not subject to insurer's credit risk.	Same.
Duties to Policyholders	A U.S. insurer is required to invest and reinvest for its separate account in good faith and with the degree of care that an ordinarily prudent person in a like position would use under similar circumstances.	Substantially similar.

⁷ The description of U.S. insurers' separate accounts reflects general principles of insurance law that, in our experience, are the typical rule in most states. We have not, however, specifically researched the laws of the 50 states in preparing this comparison.

⁸ Because MLCL is required by the Life Act to maintain regulatory capital in respect of each statutory fund, any investment income, gains and losses on the regulatory capital component inure to MLCL. As discussed in footnote 6, the statutorily required regulatory capital component should not make the investments made by statutory funds No. 2, No. 3 and No. 4 impermissible under the Volcker Rule.

Rationale/Background for the MLCL Insurance Policy Structure

A significant portion of Australian superannuation investment was historically structured through life insurance companies. For some time before superannuation was introduced, life companies issued whole life and endowment policies – these were common vehicles for longer-term savings for many individuals.

A whole life policy is a policy that remains in place for the whole life of the insured person (*i.e.*, until the insured person dies), unless withdrawn earlier. Whole life policies have a fixed death benefit plus a bonus component, if any is declared. They also accumulate a surrender value or “cash” value as premiums are paid, with the cash value being payable on early withdrawal in lieu of the benefits upon death.

An endowment policy pays a benefit if the insured lives to a stipulated age, *e.g.*, 65. For “pure endowment” policies, this is ordinarily the only benefit. For ordinary endowment policies, there is also a death benefit if the life insured dies before the stipulated age. There is a surrender value or cash value on early withdrawal for both a “pure endowment” and an “ordinary endowment” policy.

When superannuation (which was formerly known as benefits and retirement funds) became subject to lower tax rates in 1936, life insurance policies were recognized as appropriate investments for superannuation. Typically, individuals who were not employed by the government or corporations that had their own superannuation scheme would invest in a life insurance company sponsored superannuation fund if they wished to invest their monies through a superannuation vehicle. The trustee of that superannuation fund would acquire a life insurance policy on behalf of the member as a means of providing the superannuation benefit (*i.e.*, for retirement, death or disablement).