

# COMMITTEE ON CAPITAL MARKETS REGULATION

March 25, 2020

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

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

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

Vanessa A. Countryman, Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090  
File Number S7-02-20

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

VIA ELECTRONIC MAIL: [regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov); [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov);  
[comments@FDIC.gov](mailto:comments@FDIC.gov); [rule-comments@sec.gov](mailto:rule-comments@sec.gov); <https://comments.cftc.gov>

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

Ladies and Gentlemen:

The Committee on Capital Markets Regulation (the “**Committee**”) appreciates the opportunity to comment on the notice of proposed rulemaking (the “**Proposal**”) <sup>1</sup> issued by the Office of the Comptroller of the Currency (the “**OCC**”), the Board of Governors of the Federal Reserve System (the “**Board**”), the Federal Deposit Insurance Corporation (the “**FDIC**”), the Securities and Exchange Commission (the “**SEC**”), and the Commodity Futures Trading Commission (the “**CFTC**” and, together with the OCC, the Board, the FDIC and the SEC, the

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<sup>1</sup> COMPTROLLER OF THE CURRENCY, FEDERAL RESERVE SYSTEM, FED. DEP. INS. CORP., COMM. FUT. TRAD. COMM’N, SEC. & EXCH. COMM’N, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 85 FED. REG. 12,120 (Feb. 28, 2020), available at <https://www.federalregister.gov/documents/2020/02/28/2020-02707/prohibitions-and-restrictions-on-proprietary-trading-and-certain-interests-in-and-relationships-with> (the “**Proposal Release**”).

“Agencies”) to revise the regulations implementing Section 13 of the Bank Holding Company Act of 1956, commonly referred to as the “Volcker Rule.”<sup>2</sup>

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-five leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

### *The Volcker Rule and the Covered Fund Provisions*

The Volcker Rule statute generally prohibits a banking entity from (i) engaging in proprietary trading and (ii) acquiring or retaining any ownership interest in or sponsoring a hedge fund or private equity fund.<sup>3</sup> The statute permits certain seed investments and *de minimis* investments in a hedge fund or private equity fund, but these investments are subject to size limits and other restrictions.<sup>4</sup> These include requirements that: (a) not later than one year after the fund is established, the banking entity must reduce its investment to no more than 3% of the fund’s total ownership interests and (b) the banking entity’s aggregate interests in all private equity funds and hedge funds may not exceed 3% of its tier 1 capital.<sup>5</sup>

The Agencies are authorized to jointly issue regulations to implement the Volcker Rule—these regulations were originally issued in December 2013, and amendments were adopted in November 2019.<sup>6</sup> The Proposal would further revise the regulations implementing the Volcker Rule with respect to their restrictions on banking entities’ relationships with certain funds (the “Covered Fund Provisions”).

The Covered Fund Provisions generally provide that a banking entity may not, as principal, acquire or retain any ownership interest in or sponsor a “covered fund.”<sup>7</sup> “Covered fund” is defined broadly, and includes certain commodity pools, issuers that would be investment companies under the Investment Company Act of 1940 but for Section 3(c)(1) or 3(c)(7) thereof, and certain foreign

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<sup>2</sup> 12 U.S.C. § 1851.

<sup>3</sup> *See id.*

<sup>4</sup> *See* 12 U.S.C. § 1851(d)(4).

<sup>5</sup> *Id.* *See* 12 C.F.R. § 248.12 for the Agencies’ implementing regulations.

<sup>6</sup> COMPTROLLER OF THE CURRENCY, FEDERAL RESERVE SYSTEM, FED. DEP. INS. CORP., COMM. FUT. TRAD. COMM’N, SEC. & EXCH. COMM’N, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule*, 79 FED. REG. 5,535 (Jan. 31, 2014), available at <https://www.federalregister.gov/documents/2014/01/31/2013-31511/prohibitions-and-restrictions-on-proprietary-trading-and-certain-interests-in-and-relationships-with>; COMPTROLLER OF THE CURRENCY, FEDERAL RESERVE SYSTEM, FED. DEP. INS. CORP., COMM. FUT. TRAD. COMM’N, SEC. & EXCH. COMM’N, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 84 FED. REG. 61,974 (Nov. 14, 2019), available at <https://www.federalregister.gov/documents/2019/11/14/2019-22695/prohibitions-and-restrictions-on-proprietary-trading-and-certain-interests-in-and-relationships-with>. Citations to the current regulations implementing the Volcker Rule in this letter will be to those promulgated by the Board, 12 C.F.R. § 248.

<sup>7</sup> *See* 12 C.F.R. § 248.10(a).

funds of U.S. banking entities.<sup>8</sup> The Covered Fund Provisions also set forth additional limitations on banking entities' relationships with covered funds (which generally prohibit a banking entity from entering into certain transactions with a related covered fund),<sup>9</sup> permitted investments and activities with respect to covered funds,<sup>10</sup> exclusions from the definition of covered fund,<sup>11</sup> and related provisions.<sup>12</sup>

### *The Proposal*

The Proposal would revise both the scope of the Covered Fund Provisions and certain restrictions contained therein. These proposed changes are “intended to improve and streamline the covered fund provisions and provide clarity to banking entities” so that they can conduct their businesses in a manner that is consistent with the Volcker Rule.<sup>13</sup>

The Proposal would modify the scope of the Covered Fund Provisions by adding four new exclusions from the definition of “covered fund” and revising certain existing exclusions. Specifically, the Agencies propose to add new exclusions from the “covered fund” definition for (1) credit funds, (2) venture capital funds, (3) family wealth management vehicles, and (4) customer facilitation vehicles, each subject to certain conditions.<sup>14</sup> The Proposal would also revise the existing exclusion for “foreign public funds” to simplify its requirements and more closely align the treatment of foreign public funds with the treatment of U.S. registered investment companies.<sup>15</sup> Other changes to the existing exclusions would include revisions to the exclusion for loan securitizations, to permit such securitizations to hold a small percentage of non-loan assets and to codify guidance relating to that exclusion.<sup>16</sup>

The Proposal would also amend substantive requirements in the Covered Fund Provisions, including those that generally prohibit banking entities from entering into certain transactions with related covered funds. Under the Proposal, certain low-risk transactions between banking entities and related funds would now be permitted.<sup>17</sup> For example, a banking entity would be permitted to purchase municipal securities from a related covered fund and make an intraday extension of credit to such a fund, subject to specific conditions.<sup>18</sup>

### *Analysis of the Proposal*

The Committee supports the Agencies' efforts to improve, streamline and clarify the Covered Fund Provisions,<sup>19</sup> and we believe that the amendments set forth in the Proposal further these goals. In our view, the Covered Fund Provisions should not interfere with traditional banking

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<sup>8</sup> See 12 C.F.R. § 248.10(b)(1).

<sup>9</sup> See 12 C.F.R. § 248.14.

<sup>10</sup> See 12 C.F.R. §§ 248.11, 248.12 & 248.13.

<sup>11</sup> See 12 C.F.R. § 248.10(c).

<sup>12</sup> See, e.g., 12 C.F.R. §§ 248.15 & 248.16.

<sup>13</sup> See *Proposal Release*, *supra* note 1, at 12,123.

<sup>14</sup> See *Proposal Release*, *supra* note 1, at 12,177-12,180 (setting forth proposed Rule §\_\_10(c)(15)-(18)).

<sup>15</sup> See 12 C.F.R. § 248.10(c)(1); *Proposal Release*, *supra* note 1, at 12,126-12,127.

<sup>16</sup> See 12 C.F.R. § 248.10(c)(8); *Proposal Release*, *supra* note 1, at 12,123, 12,128-12,129.

<sup>17</sup> See *Proposal Release*, *supra* note 1, at 12,187 (setting forth proposed amendments to Rule §\_\_14).

<sup>18</sup> See *Proposal Release*, *supra* note 1, at 12,187 (setting forth proposed Rule §\_\_14(a)(2)); 12 C.F.R. § 223.42.

<sup>19</sup> See *Proposal Release*, *supra* note 1, at 12,123.

activities and asset management. The current Covered Fund Provisions are overbroad, unnecessarily complex, and impede banks' ability to provide critical banking-related services that drive economic growth and do not pose the risks targeted by the Volcker Rule. By refining the "covered fund" definition and, in Vice Chair Quarles' words, "permitting banking entities to engage in additional fund-related activities, which do not present the risks that the Volcker rule was intended to address,"<sup>20</sup> the Proposal would better position banks to provide U.S. businesses and individuals with essential services and capital, without increasing risks to the financial system.

We appreciate that the Proposal contains some specific revisions to the Covered Fund Provisions that the Committee has called for in our 2018 comment letter.<sup>21</sup> We specifically suggested that exclusions be created for family wealth and single-investor facilitation vehicles, noting that both are presently treated as covered funds even though managing such funds is a traditional service provided by diversified banking institutions.<sup>22</sup> The Proposal's new exclusions for family wealth management vehicles and customer facilitation vehicles are therefore welcome changes, as is the exclusion for venture capital funds. We similarly support the Proposal's new credit fund exclusion, having recommended that an exclusion be created for lending vehicles that do not engage in short-term trading.<sup>23</sup> We also highlighted the disparate treatment of foreign public funds and U.S. registered investment companies, flagging that foreign public funds must currently meet narrow and distinct criteria to avoid being swept into the "covered fund" definition. We maintained that foreign public funds should be treated the same as U.S. public funds, and are pleased that the Proposal reflects a closer alignment in its treatment of these two fund types.

To advance the Proposal's goals of improving and clarifying the Covered Fund Provisions, the Committee recommends that the Agencies create an additional exclusion from the "covered fund" definition for certain long-term investment funds, as described in Question 50 of the Proposal.<sup>24</sup> To ensure that the exclusion is appropriately narrow and within the bounds of the Volcker statute and intent of Congress, only funds that meet the criteria set forth in Question 50 should be eligible: funds (1) that make long-term investments that a banking entity could invest in directly, (2) that hold themselves out as making investments that they plan to hold for a set period of time (e.g., 2 years), (3) whose applicable offering and governing documents reflect a long-term investment strategy, and (4) that meet other enumerated requirements that, *inter alia*, limit the risks associated with the funds' activities.<sup>25</sup>

We believe that a narrowly tailored long-term investment fund exclusion would promote capital formation without increasing risk to the financial system. Banking entities are currently permitted to make certain long-term investments on their balance sheets, subject to various requirements that limit the associated risks. Such long-term investments can provide stable capital

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<sup>20</sup> Randal K. Quarles, *Statement by Vice Chair for Supervision Randal K. Quarles* (Jan. 30, 2020), available at <https://www.federalreserve.gov/newsevents/pressreleases/quarles-statement-20200130.htm>

<sup>21</sup> See COMMITTEE ON CAPITAL MARKETS REGULATION, *Comment Letter on Proposed Amendments to the Regulations Implementing the Volcker Rule* (Oct. 17, 2018), at 10, available at [https://www.capmktreg.org/wp-content/uploads/2018/10/10\\_17\\_18\\_Volcker-Letter.pdf](https://www.capmktreg.org/wp-content/uploads/2018/10/10_17_18_Volcker-Letter.pdf)

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> The Committee has supported a long-term investment fund exclusion in the past. *See id.*

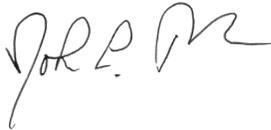
<sup>25</sup> *Proposal Release*, *supra* note 1, at 12,138. Specifically, item (4) of Question 50 refers to issuers "that meet all other requirements of the proposed qualifying venture capital fund exclusion (other than that the issuers would be venture capital funds as defined in 17 CFR 275.203(l)-1)." *See Proposal Release*, *supra* note 1, at 12,178-12,179 (setting forth proposed Rule §\_.10(c)(16)).

to U.S. businesses and drive economic growth. However, the current Covered Fund Provisions prevent banking entities from investing through a fund structure in the same long-term investments that they are permitted to invest in directly. Allowing banks to make these same long-term investments through funds would not undermine bank safety and soundness or increase systemic risk. We therefore support the long-term investment fund exclusion described by the Agencies, as it could expand sources of needed long-term capital for U.S. businesses without exposing banks or the financial system to heightened risks.

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In conclusion, the Committee supports the amendments to the Covered Fund Provisions set forth in the Proposal, as well as a further amendment to exclude from the “covered fund” definition certain long-term investment funds that satisfy the conditions outlined in Question 50 of the Proposal. We recommend that the Agencies adopt these amendments on an expedited basis and provide for their immediate effectiveness.

Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee’s President, Prof. Hal S. Scott ([hscott@law.harvard.edu](mailto:hscott@law.harvard.edu)), or Executive Director, John Gulliver ([jgulliver@capmksreg.org](mailto:jgulliver@capmksreg.org)), at your convenience.



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