Frankfurt am Main,
17 October 2018

BVI's submission to the public consultation on "proposed revisions to prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedge funds and private equity funds"

Questions Addressed: 12-21 (Banking Entity Status); 123–130 (TOTUS Exemption Requirements); 189–193 (SOTUS Exemption Requirements) and 140–154 (Foreign Public Fund Exclusion from Covered Fund Status);

BVI[1] gladly takes the opportunity to comment on the proposal tabled by the Office of the Comptroller of the Currency ("OCC"), Board of Governors of the Federal Reserve System ("Board"), Federal Deposit Insurance Corporation ("FDIC"), U.S. Securities and Exchange Commission ("SEC"), and Commodity Futures Trading Commission ("CFTC") (the "Agencies") which seeks to amend the regulations (the "Regulations") implementing Section 13 of the Bank Holding Company Act ("BHC Act"), commonly known as the Volcker Rule.[2]

Most BVI members – fund management and asset management companies with particular focus on the German market – are not active as service providers in the United States nor do they engage in marketing their funds to residents of the United States. And yet, under the current Regulations, they cannot be fully assured that the Volcker Rule will have no implications on their traditional asset management business activities in the EU. In this regard, we are grateful to the Agencies for their efforts so far to mitigate the unintended extraterritorial impact of the Volcker Rule. Nonetheless, several uncertainties with regard to the permissible activities and investments outside the U.S. remain under the current rules. Therefore, BVI welcomes the Agencies' initiative to remove those uncertainties while allowing banking entities to provide services to their clients more efficiently, albeit consistently with the requirements of the Volcker Rule.

In this light, we strive to limit our comments to those aspects of the proposal that pertain to the asset management activities of, and therefore are of greatest interest to, BVI's members. More specifically, our recommendations relate to (i) the potential banking entity status of investment funds, and particularly non-U.S. investment funds, (ii) the proposed amendments to the requirements for compliance with the TOTUS and SOTUS exemptions and (iii) the scope of the foreign public fund exclusion from covered fund status. Our comments and requests below are fully aligned with the position presented by our European umbrella organisation EFAMA.

(i) Banking Entity Status of Investment Funds (Questions 12 – 21)

The final implementing regulations ultimately reduced the scope of the term "covered fund" both by narrowing the universe of funds that initially would meet the definition of a covered fund and by adding a significant number of exclusions. These changes to the definition of covered fund were very much

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Fund companies act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's over 100 members manage assets of more than 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] *See* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Covered Funds 83 Fed. Reg. 33,432 (July 17, 2018), hereafter "the Proposal".

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welcomed by BVI and its members. Unfortunately, for technical (and apparently not policy) reasons, the Final Rules left open the possibility that both foreign private funds and foreign public funds sponsored by banking entities might themselves be deemed to be banking entities directly subject to the Volcker Rule's restrictions. While the Agencies granted further relief for foreign public funds under FAQ 14, the treatment of foreign private funds with regard to the banking entity status still remains unresolved. Hence, we believe that it is appropriate to revisit the circumstances under which an investment fund sponsored, advised or managed by a banking entity should itself be treated as a banking entity.

Recommendations:

BVI recommends that the Agencies amend the Regulations to provide a general exemption for investment funds from banking entity status, except in circumstances where the investment fund is determined to have been organised in order to permit the banking entity sponsor to engage indirectly in impermissible proprietary trading. Such an exemption would simplify greatly the ability of banking entities to engage competitively in the full range of investment management activities without the burden of a compliance program the benefits of which are far outweighed by the costs. In our view, a general exemption from the banking entity status would be particularly justified for non-US investment funds which are neither sponsored, advised nor managed by US banking entities and do not seek to sell their interests to US residents.

If the Agencies are unwilling to grant a broad exemption for bank affiliated investment funds in general, we recommend that the Agencies:

(1) expand the current FAQ guidance with respect to seed capital investments in investment companies that are registered ("RICs") with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 ("1940 Act") and in foreign public funds to also encompass other circumstances where a banking entity sponsor may own or control 25% or more of an investment fund's outstanding voting securities; and

(2) adopt a general exemption from banking entity status that is limited to foreign excluded funds that are controlled by non-U.S. banking entities as part of their bona fide asset management activities or in connection with bona fide customer facing derivatives activities and that do not seek to market their interests to US residents.

Rationale for our Recommendations:

The key term underlying the Volcker Rule and the Regulations is that of a "banking entity" to which the prohibitions and restrictions on proprietary trading and sponsoring or investing in hedge funds and private equity funds will apply absent an exemption or exclusion. The term banking entity is defined broadly to include not only FDIC-insured depository institutions, their holding companies and foreign banks that are treated as bank holding companies for purposes of Section 8 of the International Banking Act, but also any affiliate or subsidiary of such an entity. Affiliate and subsidiary are similarly defined broadly with the result that any company that controls, is controlled by or is under common control with, a banking entity will be deemed to be a banking entity absent an exemption or exclusion.

For this purpose, control is determined under the BHC Act, which provides that a company has control over another company if: (A) the company directly or indirectly or through one or more other persons

owns, controls, or has the power to vote 25% or more of any class of voting securities of the other company; (B) the company controls in any manner the election of a majority of the directors or trustees of the other company; or (C) the Board determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the other company. The Board has also consistently ruled that the general partner of a limited partnership and the managing member of a limited liability company control, respectively, the partnership and the limited liability company.

The net result of these broad definitions is that many, if not most, investment funds, both in the United States and in Europe, are at risk of being deemed to be controlled by their banking entity sponsor, investment adviser or investment manager due to their organizational and governance structure, and, thus, deemed banking entities subject to the Volcker Rule's restrictions on proprietary trading. Since investment funds are organized for the express purpose of investing in securities and other assets, deeming an investment fund that is controlled by a banking entity to itself be a banking entity would be prohibitive for that investment fund's core activity and would effectively prevent it from achieving its purpose. Fund investors would be denied the opportunity to benefit from the banking entity sponsor, investment adviser or investment manager's investment advisory services and expertise. BVI respectfully submits that such a result was neither intended nor required by the Volcker Rule.

A general exclusion for investment funds is appropriate for many reasons. Perhaps most importantly, such an exclusion would be consistent with the distinction made throughout the Volcker Rule between a banking entities activities as principal, i.e., for its own account, and a banking entities activities as fiduciary or agent for its customers. As a general principle, only when a banking entity is acting as principal do the proprietary trading and covered fund restrictions of the Volcker Rule apply. That general principle can be extended to investment funds where the banking entity investment manager exercises control over the investment fund for the benefit of the investors in the investment fund and not for its own benefit. An important additional justification for implementing such an exclusion is that it would eliminate the need to develop costly compliance structures to assure that an investment fund does not inadvertently become a banking entity.

BVI believes that the justification for excluding foreign excluded funds from banking entity status is especially compelling because Congress expressly sought to limit the extraterritorial impact of the Volcker Rule. Moreover, regardless of the outcome with respect to the general exclusion for investment funds, BVI strongly recommends that the Agencies in any event exclude foreign private funds complying with the definition of "qualifying foreign excluded funds" from the definition of a banking entity.

Theoretical concerns that a non-U.S. banking entity might rely on such a general exclusion to indirectly engage in impermissible proprietary trading or covered fund activities are, in our view, largely misplaced. As an initial matter, non-U.S. banking entities have engaged in these same types of asset management activities for years and should not be presumed suddenly to be engaging in them in an effort to avoid the Volcker Rule. In any event, the Regulations' general anti-evasion restrictions would permit the Agencies to limit any such activity were it to occur.

(ii) TOTUS Exemption (Questions 123 – 130) and SOTUS Exemption (Questions 189 – 193)

As elaborated above, BVI strongly recommends granting a general exemption from the banking entity status at least for foreign excluded funds. Should the Agencies not be willing to provide for such an

exemption, we consider it critical that the conditions for trading and investing solely outside the United States be flexible enough in order to allow for unobstructed operations of non-U.S. investment funds which are neither sponsored, advised nor managed by U.S. banking entities and do not seek to market their interests to U.S. residents.

Recommendations:

To this effect, BVI recommends the following:

(1) The Agencies' proposed amendments to the exemption from the Volcker Rule's proprietary trading restrictions for activities that take place solely outside the United States should be adopted in accordance with the Proposal. The same pertains to the proposed amendments in terms of permitted covered fund activities and investments outside the U.S. which allow for an exemption from the statutory restrictions on covered fund activities and investments.

(2) For both exemptions, it would be helpful to clarify that the requirement for the banking entity "that makes the decision to purchase or sell as a principal" (TOTUS exemption, §_.6(e)(3)(ii)) or "to acquire or retain the ownership interest or act as a sponsor to the covered fund" (SOTUS exemption, §_.13(b)(4)) not to be located in the U.S. or organized under the laws of the U.S. or of any State does not prohibit non-U.S. investment funds from utilizing the expertise of U.S. investment advisers under delegation agreements.

Rationale for our Recommendations:

We strongly support the Agencies' proposed amendments to the TOTUS and SOTUS exemptions. With respect to the TOTUS exemption in particular, the experience of our members has shown that the current requirements pertaining to trading by a non-U.S. banking entity with a U.S. counterparty are impractical and have limited the ability and willingness of non-U.S banking entities to rely on this exemption. The proposed deletion of the counterparty prong with regard to the TOTUS exemption will render its conditions more practicable. The proposed clarification under §_.13(b)(3) as to which activities of the foreign banking entity are constrained by the marketing restriction applicable under the SOTUS exemption will also provide more legal clarity to non-U.S. banking entities such as European investment funds and their management companies.

In this respect, we would welcome further clarification as regards the understanding of banking entity that makes the decision either to trade under the TOTUS exemption or to invest in a covered fund under the SOTUS exemption. In line with the general concept of control underlying the banking entity status, we believe that the provision of investment advice services by a U.S. banking entity to a foreign fund should not be deemed relevant in terms of decision-making as long as the investment advice activity does not result in acquiring control over the foreign fund or offering or selling its ownership interests to U.S. residents. Typically, a foreign investment fund may appoint a qualified U.S. investment adviser for providing investment management or investment advice services under delegation. In both cases, the ultimate responsibility for the legitimacy of trading and investment decisions and compliance with statutory and contractual investment limits remains with the foreign management company in control of the foreign investment fund.

(iii) Foreign Public Fund Exclusion from Covered Fund Status (Questions 140 – 154)

Recommendations:

BVI recommends that the Agencies amend the "foreign public fund" exclusion from the definition of covered fund to more closely align the treatment of UCITS and other regulated non-U.S. funds for purposes of the Volcker Rule with the treatment of U.S. investment companies registered under the Investment Company Act of 1940. Conditions that should be amended include the following:

(1) Requirement that the foreign public fund be sold primarily to non-U.S. investors: instead of applying a fixed threshold to determine allowable offering to residents of the United States, we recommend a qualitative test similar to the proposed amendment under §_.13(b)(3). Specifically, a foreign public fund should be deemed to be sold primarily to non-U.S. investors if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates.

(2) Requirement that the foreign public fund be sold predominantly through one or more public offerings: Instead of testing the conditions of actual marketing, we recommend shifting the focus to the foreign public fund being authorized to be sold through public offerings.

Rationale for our Recommendations:

Although the existing exclusion for foreign public funds already strives to permit foreign funds to carry out their business outside the U.S., the very specific and detailed requirements for a foreign fund to qualify for the exclusion, which do not apply to U.S. registered investment companies, significantly undermine this intent, are unnecessarily limiting and effectively place non-U.S. funds at a competitive disadvantage to U.S. registered investment companies. The amendments suggested above would render the criteria for the foreign public fund exclusion more practicable and eliminate a great deal of legal uncertainty associated with the current requirements.

In this context, we would also like to stress that we see no need to modify the requirement in §_.10(c)(1)(i) that a foreign public fund shall be authorised to offer and sell ownership interests to retail investors in the fund's home jurisdiction. This requirement is always fulfilled for UCITS, since a UCITS' authorisation including permission for public offering is always performed by the competent authority of the Member State where the UCITS is domiciled. Such authorisation, once granted, is valid for all EU Member States meaning that a UCITS can be marketed cross-border within the EU on the basis of such authorisation. Any modification of this provision, e.g. by referring to a "primary jurisdiction" instead of a fund's home jurisdiction, would rather create new problems or uncertainties for UCITS and potentially for other regulated foreign public funds.