



Box 348, Commerce Court West
199 Bay Street, 30th Floor
Toronto, Ontario, Canada M5L 1G2
www.cba.ca

Angelina Mason
General Counsel & Vice-President,
Legal
Tel: [REDACTED]
[REDACTED]

October 17, 2018

Sent via email

Board of Governors of the Federal Reserve
System
20th Street & Constitution Avenue NW
Washington, DC 20551

Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

regs.comments@federalreserve.gov
VolckerReg.Comments@occ.treas.gov
rule-comments@sec.gov
<https://comments.cftc.gov>
comments@FDIC.gov

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

Federal Reserve Docket No. R-1608 and RIN 7100-AF 06; OCC Docket ID OCC-2018-0010; SEC File Number S7-14-18; CFTC RIN 3038-AE72; FDIC RIN 3064-AE67.

Dear Sirs/Mesdames:

The Canadian Bankers Association (CBA)¹ appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission, the Commodity Futures Trading Commission and the Federal Deposit Insurance Corporation (FDIC) (together, the Agencies) on the proposed amendments (the Proposal) to the regulations implementing section 13 of the *Bank Holding Company Act of 1956*, as amended (also known as the Volcker Rule).

¹ The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca.

Canadian banks, through their provincial securities regulated asset management subsidiaries and as part of their traditional, bona fide asset management businesses, routinely establish investment funds in Canada that they offer to their Canadian institutional and high-net worth clients on a private placement basis. Subsidiaries of Canadian banks act as trustees and/or managers of these foreign excluded funds. Our key concern is that, as a result of the governance structure, these foreign excluded funds could inadvertently fall within the definition of “banking entities” under Section 13 of the *Bank Holding Company Act of 1956*, as amended, and therefore be subject to the proprietary trading and covered fund restrictions under the Volcker Rule.

Foreign excluded funds are not entitled to the exclusion from the Volcker Rule’s definition of banking entity afforded to “covered funds” because they are not offered to U.S. investors in reliance on sections 3(c)(1) or 3(c)(7) of the U.S. *Investment Company Act* (i.e., foreign excluded funds are not covered funds). Moreover, foreign excluded funds are not able to avail themselves of the relief afforded to “foreign public funds” under FAQs 14 and 16 issued by the FRB because they are not offered to retail investors in Canada.

Resolution of the foreign excluded funds issue is very important to CBA member banks. Several of our members have substantial non-U.S. investments and asset management businesses that are considerably impacted by the Volcker Rule restrictions on foreign excluded funds. The CBA supports the solution put forward by the Institute of International Bankers (IIB) with respect to foreign excluded funds in response to the Proposal. In particular, we endorse the IIB’s comments that the Agencies should:

1. Categorically exclude foreign funds controlled by a banking entity and offered solely outside the U.S. from the definition of banking entity, just as covered funds are excluded.
2. If a clean exclusion is not adopted, at minimum the foreign fund relief² for “qualifying foreign excluded funds” should be made permanent. The foreign fund relief includes a condition that a qualifying foreign excluded fund be “established and operated as part of a bona fide asset management business”. We understand the condition to include hedging investments for fund-linked products to non-U.S. customers that are written on bank-sponsored or third party foreign excluded funds, as well as other situations where an international bank has acquired a controlling interest in a foreign excluded fund that is managed by a third party as part of the third party’s bona fide asset management business (for example, in connection with managing the international bank’s treasury assets).
3. Confirm that a banking entity may “opt in” to the covered fund regime and elect to treat a foreign excluded fund as a SOTUS-exempt covered fund as a useful supplemental approach to avoiding the unintended application of the Volcker Rule to foreign excluded funds. To make the opt in approach a viable supplemental approach, the Agencies should clarify that the Super 23A prohibition is subject to the same territorial limits as section 23A itself and does not reach transactions between a non-U.S. affiliate of an international bank and non-U.S. covered funds, including foreign excluded funds that have opted into covered fund status, where the risk resides outside the U.S.

² “Foreign fund relief” refers to the statement by the FRB, the OCC and the FDIC issued July 21, 2017 indicating they would not propose to take action against a foreign banking entity based on attribution of the activities and investments of a qualifying foreign excluded fund to the foreign banking entity, or against a qualifying foreign excluded fund as a banking entity, during the one-year period ending July 21, 2018. The Proposal extends this relief until July 21, 2019.

In August 2016, the CBA submitted the proposal in Annex A (the CBA Proposal) to the Agencies requesting interpretive guidance clarifying that foreign excluded funds are not subject to the Volcker Rule's proprietary trading and covered fund restrictions and outlining the salient characteristics of these funds. While we prefer and support the IIB's position on foreign excluded funds in response to the Proposal, if the Agencies decide not to adopt one of the first two IIB proposals noted above, we encourage them to consider the CBA Proposal in the alternative, taking into account relevant changes the Agencies make in the final rule (including removing the prohibition on financing from U.S. branches and affiliates and incorporating the guidance on marketing restrictions in FAQ #13).

Thank you for the opportunity to share our comments regarding foreign excluded funds in connection with the Volcker Rule. If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to be the initials 'JM' or similar, written in a cursive style.

Annex A

CBA Proposal re. Foreign Excluded Funds

Background

Foreign excluded funds are funds established outside the U.S. which have not been offered or sold in the U.S. or in an offering that targets U.S. residents in reliance on section 3(c)(1) or 3(c)(7) of the *Investment Company Act of 1940* and are excluded from the definition of “covered fund” under section 13 of the *Bank Holding Company Act* (the Volcker Rule). Such foreign excluded funds may be subject to the proprietary trading and covered fund investment restrictions of the Volcker Rule because they may themselves be considered to be “banking entities” under the Volcker Rule by virtue of either their governance structure or ownership of 25% or more of the fund’s voting shares by the foreign bank sponsor. These outcomes would appear to be inconsistent with the exclusion of such funds from the definition of covered fund and are an unintended consequence since these funds are not created for the purpose of evading the Volcker Rule, have limited to no U.S. nexus, and consequently pose no risk to the U.S. financial system. Foreign excluded funds are part of a foreign banking organization’s traditional asset management business outside the U.S. and are a vehicle through which the investment needs of accredited, high net worth and institutional investors such as pension plans are met.

With the publication of FAQs 14 and 16, the Volcker Agencies have addressed industry concerns regarding foreign bank sponsorship and portfolio investment activities of foreign public funds. However, the Agencies have not yet addressed the comparable issues in relation to foreign excluded funds. Similar guidance is needed to provide assurance to foreign banks and fund investors that the Agencies will not apply the Volcker Rule to curb the activities of foreign excluded funds.

Guidance

We propose that, where a foreign banking entity’s sponsorship of and investment in a foreign excluded fund is conducted outside the U.S., the Agencies provide guidance clarifying that the Volcker Rule’s proprietary trading and covered fund restrictions will not apply to the foreign excluded fund’s activities, irrespective of its legal and corporate governance structure, provided:

1. The foreign banking entity does not own, control, or hold the power to vote 25% or more of the voting shares of the foreign excluded fund (after a reasonable seeding period, in accordance with FAQ 16)³;

³ FAQ 16 recognizes that the seeding period for a foreign public fund or registered investment company may take some time for seeding a covered fund under the implementing rules.

2. Management of the foreign excluded fund is conducted as part of a *bona fide* asset management business;
3. The foreign banking entity provides investment advisory, commodity trading advisory, administrative or other services to the fund in compliance with applicable limitations in the relevant foreign jurisdiction;
4. The foreign banking entity (including relevant personnel) that makes the decision to invest in or sponsor the foreign excluded fund is located outside the U.S.;
5. The foreign banking entity that holds an interest in or sponsors the foreign excluded fund is located outside the U.S.;
6. The risk of the investment in or sponsorship of the foreign excluded fund is located solely outside the U.S. (i.e., no financing is provided by U.S. affiliates for purposes of making an investment, there is no consolidation of the fund's interests up to a U.S. affiliate or branch, no related risk-mitigating hedging transaction is executed within the fund by a U.S. affiliate or branch);
7. The foreign banking entity does not participate in any marketing of ownership interests in the foreign excluded fund in any offering that targets U.S. residents;
8. The foreign excluded fund is organized or established outside the U.S.; and
9. The foreign excluded fund is not established or operated for the purpose of enabling the foreign banking entity to evade the Volcker Rule's proprietary trading or covered fund investment restrictions.