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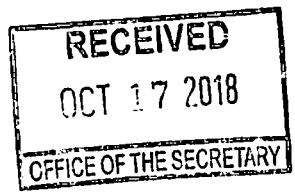

October 17, 2018

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20210

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Secretary
Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue, N.W.
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Attention: Comments/Legal ESS,
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550 17th Street, N.W.
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Brent J. Fields
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Securities and Exchange Commission
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Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in and Relationships with, Hedge Funds and Private Equity Funds, OCC: 12 C.F.R. Part 44, Docket No. OCC-2018-0010, RIN: 1557-AE27; Federal Reserve: 12 C.F.R. Part 248, Docket No. R-1608, RIN:7100-AF 06; FDIC: 12 C.F.R. Part 351, RIN 3064-AE67; SEC: 17 C.F.R. Part 255 Release No. BHCA-3; File No. S7-14-18, RIN: 3235-AM10; CFTC; 17 C.F.R. Part 75 RIN: 3038-AE72

Ladies and Gentlemen:

We appreciate the opportunity to submit a second comment letter on behalf of our client, Federated Investors, Inc.. and its subsidiaries ("Federated"),[1] in response to the request for

[1] Federated has over 45 years of experience in the business of managing investment funds (including U.S. based mutual funds and mutual funds organized and operating outside of the United States). Federated also manages client portfolio assets through individually managed accounts for corporate and state government

Footnote continued on next page

public comments on the joint rulemaking of the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commodity Futures Trading Commission and U.S. Securities and Exchange Commission[2] (the "Agencies") to revise the rules that implement the "Volcker Rule" restrictions on proprietary trading by banking entities and certain relationships between banking entities and hedge funds and private equity funds (the "Volcker Implementing Rules"). The statutory Volcker Rule is codified as Section 13 of the Bank Holding Company Act ("BHC Act"), 12 U.S.C. § 1851, and the Volcker Implementing Rules are codified at 12 C.F.R. §§ 44, 248, 351 and 17 C.F.R. §§ 75, 255.

Summary

Our comments in this letter are addressed solely at the status of regulated foreign funds as "covered funds" under the Volcker Implementing Rules, and questions 134 and 144 through 153 of the Release, which ask whether the Volcker Implementing Rules should be revised to more appropriately address and exclude foreign investment funds from the definition of "covered funds."[3] Federated agrees that such an amendment is appropriate.[4]

In Federated's view, the "foreign public funds" that are excluded from treatment as "covered funds" under the Volcker Implementing Rules should not be limited solely to funds that are publicly offered to retail investors in the jurisdiction of organization, but should also treat as a "foreign public fund" any investment fund that is regulated and

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Footnote continued from previous page
treasurers. Our earlier comment letter, filed July 17, 2018, addresses private liquidity funds, including foreign money market mutual funds that might not meet the requirements to be treated as "foreign public funds" under the Volcker Implementing Rules.

[2] *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in and Relationships with, Hedge Funds and Private Equity Funds*, 83 Fed. Reg. 33432 (July 17, 2018) (the "Release").

[3] Release at 33472-33476.

[4] Federated, as a member of the Investment Company Institute ("ICI") also agrees with the ICI comment letter submitted in the current rulemaking proposal that the treatment of foreign public funds in unduly restrictive and discriminatory under the existing Volcker Implementing Rules, and with the need for a broader exemption for regulated foreign investment funds from being treated as "banking entities" under the Volcker Rule, although we differ as to the suggested details of a broader exemption in both cases.

supervised by national securities regulators under comprehensive investment funds management statutes and regulations analogous to the European Union's directive on Undertakings for Collective Investment in Transferrable Securities ("UCITS"), European Long-Term Investment Funds regulation ("ELTIF") and Alternative Investment Fund managers directive ("AIFMD") regulatory programs. Federated therefore believes that the agencies should adopt a suggestion made by commenters in the original rulemaking to not include as "covered funds" those foreign investment companies that operate under comprehensive non-U.S. securities regulatory programs for investment funds.[5]

As both as a matter of comity as well as to more accurately track the intent of the Volcker Rule to address only unregulated funds that share portfolio and investment strategy similarities to traditional private equity and hedge funds, parallel exemptions for non-U.S. funds should also exist for the non-U.S. equivalents of U.S. business development companies ("BDCs"), small business investment companies ("SBICs"), and community reinvestment/social welfare funds ("CRA funds") operating and regulated under non-U.S. laws. For example, in Europe these include funds regulated under the European Venture Capital Funds regulation ("EuVECA") and funds regulated under the European Social Entrepreneurship Funds regulation ("EuSEF"). Federated therefore suggests that foreign investment companies similar to our BDCs and SBICs (such as EuVECA funds) or similar to our CRA/public benefit funds (such as EuSEF funds) that are regulated under specialized non-U.S. regulatory programs also be excluded from the definition of "covered funds" to establish parallel treatment and a level playing field with the exemptions applicable to U.S. business development companies, SBICs and CRA/public benefit funds.

Further, the categories of regulated foreign investment funds should not be treated as "banking entities" subject to the Volcker Rule's ban on proprietary trading, but instead -- like "covered funds" -- should be excluded from the definition of "banking entity" unless the fund directly or indirectly controls a banking entity.

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[5] Volcker Implementing Rules Adopting Release, 79 Fed. Reg. at 5672, 5677, 5738 (Jan. 31, 2014).

Analysis

What the statutory text provides. The statutory text of the Volcker Rule is aimed at "hedge funds and private equity funds" and defines them as companies that rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a (the "1940 Act") for an exemption from registration and regulation under the 1940 Act. The statute also grants the agencies with authority to address by rule other similar categories of funds.

Legislative History and FSOC Report. In enacting the Dodd-Frank Act, Congress recognized that the Volcker Rule's statutory definition of "hedge fund" and "private equity fund" was overbroad, and directed the agencies to narrow it by rule.[6]

In Section 619(b)(1) of the Dodd Frank Act, Congress directed the FSOC to study and make recommendations regarding the Volcker Rule, which were intended to be considered by the agencies in adopting the Volcker Implementing Rules pursuant to Section 619(b)(2). FSOC completed that study and issued its recommendations in January 2011. Like Congress, FSOC noted that the use of Sections 3(c)(1) and 3(c)(7) to define the scope of "hedge funds" and "private equity funds" subject to the Volcker Rule was overbroad, and recommended that the agencies narrow that definition in the rulemaking using a characteristics-based approach.[7] FSOC also suggested that the agencies expand the definition by rule to cover "funds that do not rely on the section 3(c)(1)and 3(c)(7) exclusions, but that engage in the activities or have the characteristics of a traditional private equity fund or hedge fund."[8]

The clear import of the statutory text, the legislative history created by Senate Banking Committee Chairman Dodd and House Financial Services Chairman Frank for their eponymous legislation, and the recommendation of the FSOC, is to look at the characteristics of traditional private equity funds and hedge funds, and use those

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[6] *See* Colloquy between Congressmen Frank and Himes, 156 Cong. Rec. H5226 (daily ed. June 30, 2010); Colloquy between Senators Dodd and Boxer, 156 Cong. Rec. S5904 (daily ed. July 15, 2010).

[7] FSOC, *Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships With Hedge Funds & Private Equity Funds* (Jan. 2011) at 7, 61-62.

[8] *Id.* at 62.

characteristics to narrow the definition by rule to exclude a range of investment funds and corporate structures that rely on Sections 3(c)(1) or 3(c)(7) but are not similar in character to traditional private equity funds or hedge funds, and if necessary to prevent evasion, to expand the definition to capture funds that exhibit the characteristics of traditional private equity or hedge funds but that do not rely on Sections 3(c)(1) or 3(c)(7).

Foreign investment companies are not within Volcker Rule statutory definition of "hedge fund or private equity fund." Foreign investment companies generally do not rely on Sections 3(c)(1) or 3(c)(7) of the 1940 Act because they do not meet the requirements of either exemption. Section 3(c)(1) requires that the fund have not more than 100 beneficial owners and not be publicly offered. Section 3(c)(7) allows a fund to have an unlimited number of beneficial owners, but requires that they all be very high net worth or institutional "qualified purchasers," and requires that the fund not be publicly offered. If a U.S. fund meets those requirements it is not required to register with the SEC under the 1940 Act, and is largely unregulated, other than for fraud.

In contrast, foreign funds typically have more than 100 beneficial owners, and those investors are not limited to "qualified purchasers." If they were organized under U.S. law they would be required to register with the SEC under the 1940 Act, regardless of whether they conducted public offerings of their securities, and regardless of whether there was some other suitability test applied to allow investors to own shares.

Section 7(d) of the 1940 Act prohibits foreign investment companies from registering under that Act. For many decades, the SEC in a series of interpretive or no-action letters has allowed foreign investment companies to privately place their securities with U.S. investors, provided that the investors in the U.S. private offerings are limited to either 100 U.S. beneficial owners, or to U.S. qualified purchasers.[9] But shares sold to investors outside the U.S. are not limited by these interpretations, and the foreign funds relying on these SEC letters can have any number of shareholders who are not subject to any sort of investor suitability standards, may conduct public or private offerings of their securities outside the United States, and may or may not be subject to comprehensive investment fund regulation outside the United States. These foreign funds do not meet the §§ 3(c)(1) or the 3(c)(7) exemptions to the 1940 Act.

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[9] *Goodwin, Proctor & Hoar* (SEC Staff Letter avail. Oct. 5, 1998); *Touche Remnant & Co.* (SEC Staff Letter avail. Aug. 27, 1984).

The 2011-2013 Rulemaking. In the 2011 Rulemaking proposal, the agencies proposed to treat foreign investment companies as "covered funds" if they would qualify for the section 3(c)(1) or 3(c)(7) exemption based upon their ownership and nature of the offering, including offerings and ownership outside the U.S.[10] The agencies did not propose to look at the portfolio and risk characteristics of the foreign funds to determine whether they were "similar" funds to those of traditional private equity funds and hedge funds, as Congress expected and FSOC had recommended. Instead, the agencies proposed to include any foreign fund that would meet the Section 3(c)(1) or 3(c)(7) exemption if they were owned, operated and offered in the same manner within the United States. The agencies also proposed to retain authority to designate particular funds as "similar" funds and thus "covered funds."

This approach drew a strong negative response from foreign regulators, foreign trade associations and banks as well as US trade associations and banking organizations. Commentors pointed out that this approach would require funds to determine whether they fit within an exemption that was normally not relevant to investment companies operating outside of the United States. Commenters noted this could interfere with the regulation of funds outside the U.S., such as UCITS funds.[11]

Commenters also noted that this approach to "similar funds" was "extraordinarily broad, with the potential to capture numerous long-only products globally that are not 'hedge funds' or 'private equity funds' in the traditional sense."[12]

Commenters urged that an exemption be created for foreign regulated funds, such as UCITS funds, "to ensure a level playing field vis-a-vis U.S. investors since these funds do not pose the risk of traditional 'hedge funds' or 'private equity funds.'"[13]

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[10] 76 Fed. Reg. 68846 (Nov. 7, 2011).

[11] Comment of Francois Delooz, BNP Paribas Investment Partners (Feb. 13, 2012); SEC Division of Trading and Markets, Memorandum of Meeting with EU Economics Counselors (Apr. 25, 2012); Comments of Jean-Pierre Jouyet, Chairman, Autorite des marche financiers, Ramon Fernandez, Director, Direction General du Tresor, Christian Noyer, Chairman, Autorite de controls prudential.

[12] BlackRock Summary of Legal Arguments, attached to SEC Division of Investment Management Memorandum of Meeting With BlackRock in File No S7-41-11 (Dec. 5, 2012) at 1.

[13] Comments of Federation Bancaire Francaise (Feb. 13, 2012) at 3.

As discussed above, foreign funds generally are not within the literal definition of "private equity fund" and "hedge fund" in the statute and regulated foreign funds do not share the characteristics of traditional private equity funds or hedge funds. Regulated foreign funds do not belong in the definition of "covered funds" in the Volcker Implementing Rules.

But with a tweak to exempt publicly-offered foreign funds (with the term "publicly offered" defined very narrowly), the agencies chose in the final rules adopted in 2013 to adopt an expansive definition of "covered funds" anyway.

The fact that foreign funds were specifically added to the Volcker Implementing Rules' definition of "covered funds" in subsection __.10(b)(iii) demonstrates that the agencies expanded from the statutory definition in the Volcker Rule to reach foreign funds that are otherwise not within the statutory definition of private equity fund or hedge fund. And, contrary to the intent of Congress and the recommendation of FSOC, that definitional expansion in the Volcker Implementing Rules was not based upon the foreign funds having portfolio, investment strategy or risk characteristics similar to traditional private equity funds or hedge funds.

Regulated Foreign Funds Inappropriately Deemed "Similar" to Hedge Funds and Private Equity Funds in Volcker Implementing Rule. Because they do not in fact fit within the 1940 Act §§ 3(c)(1) or 3(c)(7) exemptions, foreign investment funds generally are not within the Volcker Rule's statutory definition of "hedge fund" or "private equity fund." Foreign funds are included within the definition of "covered funds" in the Volcker Implementing Rules because the agencies chose to add them as funds that are "similar" to U.S. §§ 3(c)(1) and 3(c)(7) exempt funds. However, comprehensively regulated foreign funds are not "similar" to U.S. funds that operate within those exemptions, any more so than U.S. registered investment companies are "similar" to U.S. §§ 3(c)(1) and 3(c)(7) funds.

The direction to the agencies from Congress and the recommendation of FSOC was to look at the characteristics of traditional hedge funds and private equity funds. Congress did *not* to direct the agencies to look at the legal parameters to the Section 3(c)(1) and 3(c)(7) exemptions and analogize from there to expand the definition of "covered funds."

A key characteristic of both hedge funds[14] and private equity funds is the use of leverage,[15] although at private equity funds that debt is incurred at the captive portfolio company level.[16] A feature that distinguishes private equity funds from most other types of funds is a portfolio of illiquid, hard-to-value securities (generally controlling or large equity stakes in private companies) and the necessary restrictions on redemption of fund shares that feature necessitates.[17] A feature that distinguishes hedge funds from many other categories of funds is investment in a broad range of securities (typically non-control positions in publicly-traded companies) and derivatives, and the use of short positions, arbitrage, and other non-traditional investment strategies.[18]

A key feature of hedge funds and private equity funds in the United States is that they are largely unregulated. What the statutory references to Sections 3(c)(1) and 3(c)(7) of the 1940 Act in the Volcker Rule's definition of "hedge fund" and "private equity fund" signify is that these funds are essentially unregulated. But the criteria to qualify for the Sections 3(c)(1) and 3(c)(7) exemptions under the 1940 Act do not translate well for the foreign regulatory programs applicable to foreign funds. Meeting the Section 3(c)(1) and 3(c)(7) exemption requirements generally will not exempt a foreign fund from comprehensive investment company regulation outside the United States.

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[14] Financial Stability Board, *Global Shadow Banking Monitoring Report 2017*, at 23-24 (Mar. 2018) (describing leverage at hedge funds).

[15] SEC Division of Investment Management Analytics Office, *Private Funds Statistics. Fourth Calendar Quarter 2017* at 8 (Aug. 2, 2018) (showing significant fund-level leverage at hedge funds, less at private equity funds); IOSCO, *Private Equity: Final Report* at 10, 14, 17 (May 2008) (describing extensive and growing use of debt in private equity transactions and the risks that poses).

[16] Blomberg, *Private Equity Transactions: Understanding Some Fundamental Principles*, 17 ABA Bus. Law. No. 3 (Jan./Feb. 2008); Primack, *How much debt do private equity firms really use?* Fortune (Jan. 6, 2011) (describing debt as comprising the majority of financing for private equity transactions, booked at holding company separately above each portfolio investment).

[17] IOSCO, *Private Equity: Final Report* at 26 (May 2008) (summary of comments noting the appropriateness of using closed-end funds for private equity because the assets are illiquid).

[18] Financial Stability Board, *Global Shadow Banking Monitoring Report 2017*, at 23-24 (Mar. 2018) (listing most common investment strategies at hedge funds as equity long/short, other/multi-strategy, macro and fixed income arbitrage, and discussing use of derivatives). SEC Division of Investment Management Analytics Office, *Private Funds Statistics. Fourth Calendar Quarter 2017* at 19 (Aug. 2, 2018) (showing large derivatives positions of hedge funds as a percentage of fund net asset value).

Rather than focusing on public versus private offerings, the better question to determine whether a foreign fund is "similar" to a U.S. private investment fund is to ask whether the foreign fund is comprehensively regulated by securities regulators in the jurisdiction of its primary market. As was pointed out by many commenters in the rulemaking in 2011-2013, Europe and many other jurisdictions have comprehensive regulatory programs for investment funds that are closely analogous to the 1940 Act.[19] For example, in the European Union, the UCITS regulation and national laws of the member states of the E.U. impose comprehensive structural, governance, portfolio, leverage, disclosure, regulatory oversight, and other requirements that are similar to those in the 1940 Act. The conditions in Sections 3(c)(1) and 3(c)(7) of the 1940 Act do not drive whether a foreign fund is regulated under these non-U.S. investment company laws.

Indeed in some jurisdictions, for example the European Union, substantially all investment funds are subject to comprehensive regulatory programs that address disclosures, governance, conflicts of interest, fund portfolio content, diversification, leverage and risk characteristics, reporting to investors, and regulatory oversight by securities regulators. In the E.U., as described above at pages 2-3, these programs include UCITS, ELTIF, AIFM, EuVECA, EuSEF and EuSEF. They simply do not have unregulated investment funds in the European Union and various other jurisdictions in the way that we do in the United States. Other jurisdictions outside of the E.U. with active international banking systems, including Australia, Brazil, Canada, China, Japan, New Zealand, South Africa and South Korea, have comprehensive programs for regulation of investment funds that are analogous to the SEC's regulation of investment companies under the 1940 Act.

There is precedent in federal banking agency rules for according equivalent status to U.S. registered investment companies and funds regulated under these foreign investment company regulatory programs. The federal banking agencies' capital rules are operationally intertwined with the Volcker Rule both by statute,[20] and in the terms of the Volcker Implementing Rules.[21] The federal banking agencies' capital rules look to foreign programs for regulation of money market mutual funds ("MMFs") in establishing

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[19] *Supra* notes 9-12.

[20] 12 U.S.C. §§ 1851(a)(2), (c)(5), (d)(3), (d)(4)(B).

[21] Volcker Implementing Rules §§ __.12(a)(2)(ii), (d).

the capital requirements for bank investments in MMFs.[22] The Volcker Implementing Rules should be amended to treat foreign investment companies that are comprehensively regulated by securities regulators outside the United States the same as U.S. registered investment companies and BDCs, and exempt foreign regulated equivalents of SBICs and CRA funds as well.

The agencies acknowledge, both in the Volcker Implementing Rules Adopting Release and in the Interagency Volcker Rule FAQs, that the lack of comprehensive regulation of private investment funds was central to "the definition of private equity fund and hedge fund in section 619 of the Dodd-Frank Act"[23] and that the definition "appears to reflect Congressional concerns regarding less regulated private funds as well as an intention not to disrupt registered investment companies, such as U.S. mutual funds."[24] The agencies have stated that the retail public offering conditions imposed on use of the foreign public fund exemption "were designed to mirror the characteristics of U.S. mutual funds that are outside the applicability of section 619 of the Dodd-Frank Act."[25]

The problem with the approach in the existing rule to foreign investment funds is twofold. First, it focuses solely on the private offering/retail public offering distinction that is part of the legal parameters of the Section 3(c)(1)/3(c)(7) exemptions rather than on the characteristics of a traditional private equity fund or hedge fund as Congress and FSOC intended. Second, it does not in fact "mirror the characteristics of U.S. mutual funds that are outside the applicability of section 619 of the Dodd-Frank Act." U.S. registered mutual funds are not required to conduct public offerings of their securities, are not required to conduct retail offerings of their securities, are not required to eschew

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[22] 12 C.F.R. §§ 3.2, 217.2, 324.2 ("*Money market fund* means an investment fund that is subject to 17 CFR 270.2a-7 or any foreign equivalent thereof.")

[23] Volcker FAQs question 14, *citing* 79 FR at 5666 and 5675 ("Section 13's definition of private equity fund and hedge fund by reference to section 3(c)(1) and 3(c)(7) of the Investment Company Act appears to reflect Congress' concerns about banking entities' exposure to and relationships with investment funds that explicitly are excluded from SEC regulation as investment companies.").

[24] *Id.*

[25] Volcker FAQs question 14, citing 79 FR at 5678 (stating "the Agencies' view that the foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act").

suitability requirements for investors in their offerings, and are not required to offer their securities primarily in the United States. Moreover, failing to do those things does not -- without a lot more -- qualify U.S. investment funds for the 3(c)(1) or 3(c)(7) exemption from the 1940 Act or cause them to be "hedge funds" or "private equity funds" as defined in the statutory text of the Volcker Rule or "covered funds" within the meaning of the Volcker Implementing Rules. Thus, the foreign public fund exemption fails its intended purpose of "prevent[ing] the extension of the definition of covered fund from including foreign funds that are similar to U.S. registered investment companies, which are by statute not covered by section 13."[26]

Where the agencies' approach to "similarity" went wrong on regulated foreign funds. Rather than focus on the obvious similarity between regulated foreign funds and U.S. registered investment companies -- that they are comprehensively regulated -- the agencies focused instead on one shared element of the Section 3(c)(1) and 3(c)(7) exemptions -- that they are not publicly offered. This approach ignores the fact that U.S. registered investment companies can privately offer their shares. It ignores the fact that a U.S. investment fund that does not conduct a private offering must still register with the SEC and be regulated under the 1940 Act if it has more than 100 beneficial owners and any of them is not a "qualified purchaser." Conducting a public offering of its securities is not a defining aspect of being a U.S. registered investment company. Not conducting a public offering does not exempt a U.S. investment fund from being required to register under the 1940 Act.

But the agencies went even further off course by limiting what constitutes a "public offering" to offerings that are available to retail investors in the fund's jurisdiction of formation without net worth qualification requirements. The private offering exemption in the federal securities laws has a meaning that has developed through interpretations laid down over the last 85 years, and that is not it.

The United States uses the public offering of securities as one of the legal criteria triggering registration and regulation of an investment fund pursuant to the 1940 Act. As defined in the statutory provisions of the Volcker Rule, SEC-registered and regulated investment funds are excluded from the definition of "hedge funds and private equity

[26] 79 Fed. Reg. 5673.

funds." Other countries do not have the same triggers as to which investment funds get comprehensively regulated. In choosing to extend the Volcker Rule covered fund restrictions to non-U.S. funds, the Volcker Implementing Rules are imposing a U.S.-based regulatory trigger -- whether the fund is publicly offered to retail investors in its jurisdiction of formation -- on foreign funds that operate in countries with regulatory programs that do not use the same defining terms to invoke comprehensive regulation. If the goal is to select out from the "covered funds" definition those non-U.S. funds that are comprehensively regulated overseas, something is lost in translation by using the "public offering" trigger from Sections 3(c)(1) and 3(c)(7) of the 1940 Act to determine which non-U.S. funds are comprehensively regulated.

Part of the current definition in the Volcker Implementing Rules of "public offering" is that the "distribution does not restrict availability to investors having a minimum level of net worth or net investment assets".[27] Under U.S. securities laws, public offerings conducted through SEC-registered broker-dealers (as virtually all are) are subject to suitability rules of the Financial Industry Regulatory Authority ("FINRA") that require the offering broker-dealer to evaluate the financial situation and needs of potential offerees, the investor's age, tax status, risk tolerance (meaning the ability and willingness to lose money on the investment), investment experience, other investments and other customer-specific factors that are highly correlated with net worth and investable assets.[28] This test specifically requires the broker-dealer to know and take into account the potential investor's tax bracket (a measure closely correlated with income and net worth), investment experience (a measure closely related and normally benchmarked by their current investment assets and prior investments). Different, less restrictive suitability standards apply in recommendations to institutional customers. The SEC has proposed to expand upon these retail screening requirements in proposed Regulation Best Interest ("Proposed Regulation BI").[29] Proposed Regulation BI would require broker-dealer firms when recommending securities to retail investors to first evaluate whether the investment is in the best interests of that retail investor, taking into account the investor's age, other investments, financial situation and needs, tax status, investment experience, investment objectives, risk tolerance, and other information the investor discloses to the

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[27] Volcker Implementing Rule § __.10(c)(1)(iii)(B).

[28] FINRA Conduct Rule 2111; FINRA Notice to Members No. 13-31 (Sep. 2013) at 7.

[29] SEC, Proposed Rule, *Regulation Best Interest*, 83 Fed. Reg. 21574 (May 9, 2018).

broker-dealer. These criteria are highly correlated with the retail investor's net worth and net investment assets.

Thus, while it literally may be the case under U.S. securities laws that the requirements of the Securities Act of 1933 for registered U.S. public offerings do not impose restrictions on who can invest based upon minimum net worth or net investment assets, those types of restrictions are in fact baked into how the securities must be offered to retail investors under FINRA rules adopted under the Securities Exchange Act of 1934 (the "1934 Act") and are contained in the SEC's Proposed Regulation BI. Further, underwriting agreements generally impose a requirement on the selling group to comply with applicable securities laws in offering the securities, which implicitly impose the FINRA suitability rule requirements and will include Regulation BI on the manner of public offering of the securities by the selling group members.

The standard in subsection __.10(c)(1)(iii)(B) of the Volcker Implementing Rules as to what constitutes a foreign "public offering" and a "foreign public fund" is one that U.S. registered investment companies and public offerings generally could not meet, taking into account the interplay between FINRA Rules and other 1934 Act requirements and the manner in which U.S. securities laws require public offerings of securities to be conducted within the United States.

Moreover, publicly-offered mutual funds offer different classes of shares with different fee structures for different categories of investors. "Institutional" classes generally are limited to institutional purchasers, for example banks and registered investment advisers that purchase mutual fund shares for the accounts of their fiduciary clients with fewer embedded fees. If a U.S. mutual fund, registered under the 1940 Act, offers only so-called "I-Shares," that mutual fund is not a "covered fund." Period. In contrast, when an identical non-U.S. mutual fund operating in Europe under the UCITS regime or in Australia, Canada, or Hong Kong for example, under those nations' comprehensive investment company regulatory programs, publicly offers only "I-shares," that fund is not a "foreign public fund" and is treated as a "covered fund" unless another exemption is available.

This does not create a level playing field, but instead one tilted against regulated foreign investment funds, in categorizing what types of investment funds are "covered funds"

subject to the Volcker Rule's prohibitions on banking entities' sponsorship and investment.

Moreover, the other exemptions in the Volcker Rule (and Volcker Implementing Rules) for SBICs, CRA funds, historic tax credit funds and other public welfare funds (which generally are privately placed rather than publicly offered) did not include any clear parallel exemptions for non-U.S. analogs. That should be remedied by recognizing an exemption for non-U.S. funds, such as European EuVECA funds and EuSEF funds, that serve similar purposes under defined regulatory frameworks in jurisdictions outside the United States.

Conclusion

The agencies have authority pursuant to Subsection (d)(1)(J) of the Volcker Rule to amend the Volcker Implementing Rules to establish the definitional characteristics of "foreign public funds" that are excluded from the definition of "covered funds" or otherwise exempt banking entities' investments in specified types of foreign public funds from the covered funds ownership prohibition of the Volcker Rule.[30]

The term "foreign public fund" in the Volcker Implementing Rules should be revised to include any publicly-offered or privately-placed investment fund that is regulated by the European Union under the UCITS, ELTIF or AIFMD legislation, or that is comprehensively regulated by another national securities regulator under similarly rigorous substantive securities laws of that nation. Similarly, the Volcker Implementing Rules should be amended to exclude from the definition of "covered funds" those foreign funds that operate and are regulated by foreign regulators in a manner analogous to U.S. SBICs and CRA funds. Finally, all of these investment funds should be excluded from the definition of "banking entity" under the Volcker Implementing Rules.

Federated's responses to Release questions 134 and 140 through 153 are contained in the attached Appendix.

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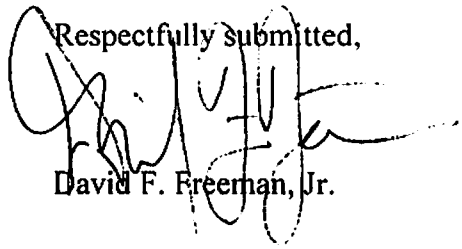
[30] 12 U.S.C. § 1851(d)(1)(J).

We appreciate the opportunity to submit this comment on the proposed amendments to the Volcker Implementing Rules and thank you for your consideration of these comments. If you have any questions or wish to discuss them further, please do not hesitate to contact me at ([redacted]).

Respectfully submitted,



David F. Freeman, Jr.

Appendix/Responses to Questions 134 and 140-153

Set forth below are a portion of the discussion and questions 134 and 140-153 from pages 33472-33476 of the Release, with the questions in bold below and our responses follow each question.

> **Question 134. The 2013 final rule's definition of "covered fund" includes certain funds organized and offered outside of the United States with respect to a U.S. banking entity that sponsors or invests in the fund in order to address structures that might otherwise allow circumvention of the restrictions of section 13. Does this "foreign covered fund" provision effectively address those circumvention concerns? If not, should the Agencies modify this provision to address those circumvention concerns more directly or in some other way? If so, how?**

The foreign covered funds provisions should be modified to exclude comprehensively regulated foreign funds, such as European UCITS, ELTIF, EuVECA, EuSEF and AIFMD funds, as well as comprehensively regulated Australian, Brazilian, Canadian, Chinese, New Zealand, South African and South Korean Funds. They are closely analogous to US registered investment companies, BDCs, SBICs, CRA funds and not at all like unregulated, traditional US private equity funds or hedge funds.

The agencies in the Rulemaking viewed evasion as the prime directive in expanding the scope of the Volcker Rule to include foreign funds and forgot to look for characteristics-based similarities to traditional private equity funds and hedge funds as Congress intended and FSOC recommended. The Agencies' stated purpose behind including the convoluted retail public offering requirement on foreign investment funds to fall outside the greatly expanded scope of the definition of "covered funds" was to "to avoid circumstances that could result in an evasion of section 13 and the final rule".[177] The Volcker Implementing Rules Adopting Release used the terms "evade" "evasion" and "anti-evasion" more than 120 times, while using the term "traditional" or "traditionally" in the same sentence as a reference to investment funds or securitizations fewer than ten times, and used the phrase "traditional private equity funds and hedge funds" or

[177] 79 Fed. Reg. at 5678.

"traditional hedge funds and private equity funds" only twice.[178] By placing so much emphasis on the potential for evasion, the rulemaking lost sight of what Congress intended.

Focusing on a bizarrely limited version of what constitutes a "public offering," which itself is related to the terms of the 3(c)(1) and 3(c)(7) exceptions rather than to the characteristics of traditional private equity and hedge funds, misconstrued the intent of the statute and the agencies' marching orders from Congress and the FSOC Report. The true characteristics of traditional private equity funds and hedge funds are that: (1) they are largely unregulated, (2) they make significant use of leverage, (3) for hedge funds they often use non-traditional strategies that include significant use of derivatives, short positions and arbitrage, and (4) for private equity funds, they take significant, often controlling positions, in non-public companies that are not start-ups or early-stage firms.

Placing suitability limits on who can invest is something U.S. registered investment companies do, as do SBICs, BDCs and CRA funds. It is not an appropriate defining characteristic of a traditional hedge fund or private equity fund, nor should it be a touchstone defining what foreign funds are "covered funds" for Volcker Rule purposes.

Question 140. Are foreign funds that satisfy the current conditions in the FPF exclusion sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? Why or why not? Are there foreign funds that cannot satisfy the exclusion's conditions but that are nonetheless sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? If so, how should the Agencies modify the exclusion's conditions to permit these funds to rely on it? Conversely, are there foreign funds that satisfy the exclusion's conditions but are not sufficiently similar to RICs such that it is not appropriate to exclude these funds from the covered fund definition? If so, how should the Agencies modify the exclusion's conditions to prohibit these funds from relying on it? Conversely, are changes to the FPF exclusion necessary given the other changes the Agencies are proposing today and on which the Agencies seek comment?

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[178] 79 Fed. Reg. 5669; 5671 fn 1678.

The current foreign private fund (FPF) exclusion is an unduly narrow carve-out from an unwarranted massive expansion by rule from the statutory definition in the Volcker Rule. The expansion conflicts with the plain language of the statute ("similar" means similar to the characteristics of private equity funds and hedge funds, not similar to the provisions of sections 3(c)(1) and 3(c)(7)), contradicts the stated intent of Congress in the Dodd and Frank colloquies, and goes against the recommendations of FSOC. The foreign funds provisions should be modified to exclude comprehensively regulated foreign funds from the definition of "covered funds" without regard to whether, where, when or how they conduct public offerings or who owns them.

Question 141. RICs are excluded from the covered fund definition regardless of whether their ownership interests are sold in public offerings or whether their ownership interests are sold predominantly to persons other than the sponsoring banking entity, affiliates of the issuer and the sponsoring banking entity, and employees and directors of such entities. Is such an exclusion appropriate? Why or why not?

Yes. Had Congress intended RICs to be covered based on whether they conduct public offerings, the Volcker Rule's scope would have been written differently, and the Dodd and Frank colloquies would have gone in a very different direction. The relevant measure of what is a "similar" fund to a traditional private equity fund or hedge fund is the portfolio and capital structure of the fund, and whether it is comprehensively regulated. The same standard of looking at whether the fund is comprehensively regulated should also be the key characteristic in the test for whether a foreign fund is excluded from the definition of a "covered fund."

Question 142: As discussed above, the Agencies designed the FPF exclusion to identify foreign funds that are sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition, but included additional conditions not applicable to RICs in part to limit the possibility for evasion of the 2013 final rule. Do FPFs present a heightened risk of evasion that justifies these additional conditions, as they currently exist or with any of the modifications on which the Agencies request comment below? Why or why not?

No. Comprehensively regulated foreign funds are closely analogous to U.S. registered investment companies, BDCs, SBICs and CRA funds. They do not present a risk of evasion of the Volcker Rule.

Question 143: As an alternative, should the Agencies address concerns about evasion through other means, such as the anti-evasion provisions in § __.21 of the 2013 final rule?[160]

Yes. If a comprehensively regulated foreign investment company shares portfolio characteristics with a traditional private equity fund or hedge fund, is offered in the United States, and is being used in a way that evades the Volcker Rule and presents material risk to a U.S. Banking entity or to the U.S. Financial system, the agencies should take action to address that risk and the evasion behind it. But that should be the rare case, not the baseline assumption to expand the Volcker Rule's "covered funds" provision far beyond its statutory definition and make it presumptively applicable to all foreign investment funds.

Question 144. One condition of the FPF exclusion is that the fund must be "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction." The Agencies understand that banking entities generally interpret the 2013 final rule's reference to the issuer's "home jurisdiction" to mean the jurisdiction in which the issuer is organized.

Is this condition helpful in identifying FPFs that should be excluded from the covered fund definition? Why or why not? The Agencies provided guidance regarding the 2013 final rule's current reference to "retail investors."[162] Has

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[160] **Section __.21 of the 2013 final rule provides in part that whenever an Agency finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or the 2013 final rule, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or the 2013 final rule, the Agency may take any action permitted by law to enforce compliance with section 13 of the BHC Act and the 2013 final rule, including directing the banking entity to restrict, limit, or terminate any or all activities under the 2013 final rule and dispose of any investment.**

[162] **See supra note 153.**

this provided sufficient clarity? Additionally, as discussed below, the 2013 final rule contains an additional condition requiring that to meet the exclusion, a fund must sell ownership interests predominantly through one or more public offerings outside the United States. As an alternative to requiring that the fund be authorized to sell interests to retail investors, should the Agencies instead require that the fund be authorized to sell interests in a "public offering"?

Comprehensively regulated foreign funds, such as UCITS funds, should be excluded from the definition of "covered funds." Adding a requirement that the regulated foreign fund be publicly offered to retail investors in its jurisdiction of formation without net worth or investor qualification requirements makes no more sense that requiring US RICs to be publicly offered in Delaware to any and all retail investors without suitability requirements as a condition to not being "covered funds." It is a requirement that is not related to the characteristics of traditional private equity funds and hedge funds. It is not related to risk to the banking entity or the financial system or potential evasion. It is a requirement not imposed on U.S. registered investment companies as a condition to registration under the 1940 Act or exclusion from the definition of "covered funds" under the Volcker Rule.

Question 145. The Agencies understand that some funds may be formed under the laws of one non-U.S. jurisdiction, but offered to retail investors in another. For example, Undertakings for Collective Investment in Transferable Securities ("UCITS") funds and investment companies with variable capital, or SICAVs, may be domiciled in one jurisdiction in the European Union, such as Ireland or Luxembourg, but may be offered and sold in one or more other E.U. member states. In this case a foreign fund could be authorized for sale to retail investors, as contemplated by the FPF exclusion, but fail to satisfy this condition. Should the Agencies modify this condition to address this situation? If so, how?

Comprehensively regulated foreign funds, such as UCITS funds, should be excluded from the definition of "covered funds". See response to question 144 above.

Question 146. Should the Agencies, for example, modify the condition to omit any reference to the fund's "home jurisdiction" and instead provide, for example, that the fund must be authorized to offer and sell ownership interests to retail investors in "the primary jurisdiction" in which the issuer's ownership

interests are offered and sold? Would that or a similar approach effectively identify funds that are sufficiently similar to RICs, including funds that are formed under the laws of one jurisdiction and offered and sold in another? For purposes of determining the primary jurisdiction, would the Agencies need to define the term "primary" or a similar term to provide sufficient clarity? If so, how should the Agencies define this or a similar term? Are there funds for which it could be difficult to identify a "primary" jurisdiction? Does the condition need to refer to a "primary jurisdiction," or would it be sufficient to require that the fund be authorized to offer and sell ownership interests to retail investors in "any jurisdiction" in which the issuer's ownership interests are offered and sold? Should the exclusion focus on whether the fund is authorized to make a public offering in the primary, or any, jurisdiction in which it is offered and sold as a proxy for whether it is authorized for sale to retail investors?

If the Agencies were to make a modification like the one described immediately above, should the exclusion retain the reference to the issuer's "home" jurisdiction? For example, should the Agencies modify this condition to require that the fund be "authorized to offer and sell ownership interests to retail investors in the primary jurisdiction in which the issuer's ownership interests are offered and sold," without any reference to the home jurisdiction?

Would this modification be effective, or does the exclusion need to retain a reference to an issuer the ownership interests of which are authorized for sale to retail investors in the home jurisdiction, as well as the primary jurisdiction in which the issuer's ownership interests are offered and sold? Why? If the rule retained a reference to authorization in the fund's home jurisdiction, would this raise concerns if a fund were authorized to be sold to retail investors in the fund's home jurisdiction, but was not sold in that jurisdiction and instead was sold to institutions or other non-retail investors in a different jurisdiction in which the fund was not authorized to sell interests to retail investors or to make a public offering? Are there other formulations the Agencies should make to identify foreign funds that are authorized to offer and sell their ownership interests to retail investors? Which formulations and why?

See responses to questions 143-145 above. This requirement is not appropriate in the context of the text of the statute, its legislative history, the FSOC recommendations, or

the risks to the financial system at which the statute was addressed. It cannot be fixed by minor modifications. It needs to be eliminated.

Question 147. Under the 2013 final rule, a foreign public fund's ownership interests must be sold predominantly through one or more "public offerings" outside of the United States, in addition to the condition discussed above that the fund must be authorized for sale to retail investors. One result of this "public offerings" condition is that a fund that is authorized for sale to retail investors—including a fund authorized to make a public offering—cannot rely on the exclusion if the fund does not in fact offer and sell ownership interests in public offerings. Some foreign funds, like some RICs, may be authorized for sale to retail investors but may choose to offer ownership interests to high-net worth individuals or institutions in non-public offerings. Do commenters believe it is appropriate that these foreign funds cannot rely on the FPF exclusion? Should the Agencies further tailor the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering, as discussed above, rather than whether the fund interests were actually sold in a public offering? Would the investor protection and other regulatory requirements that would tend to make foreign funds similar to a U.S. registered fund generally be a consequence of a fund's authorization for sale to retail investors or authorization to make a public offering?

If a fund is authorized to conduct a public offering in a non-U.S. jurisdiction, would the fund be subject to all of the regulatory requirements that apply in that jurisdiction for funds intended for broad distribution, including to retail investors, even if the fund is not in fact sold in a public offering to retail investors?

Comprehensively regulated foreign funds such as UCITS funds should simply be exempt. The requirement of a public offering, and the bizarrely limited definition of what constitutes a "public offering" is not a characteristic of a private equity fund or a hedge fund, it is an element of the legal exemptions in sections 3(c)(1) and 3(c)(7). These are not requirements imposed on U.S. registered investment companies as a condition to registration under the 1940 Act or exclusion from the definition of "covered funds" under the Volcker Rule. They are not based upon the statute or the risks it is intended to address.

Question 148. The 2013 final rule defines the term "public offering" for purposes of this exclusion to mean a "distribution" (as defined in § __.4(a)(3) of the 2013 final rule) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that (i) the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; (ii) the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and (iii) the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.[163]

If the Agencies were to modify the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering—rather than whether the fund's interests were actually sold in a public offering—should the Agencies retain some or all of the conditions included in the 2013 final rule's definition of the term "public offering"? For example, should the Agencies retain the requirement that a public offering is one that does not restrict availability to investors having a minimum level of net worth or net investment assets; and/or the requirement that an FPF file or submit, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available? Would either of these two conditions, either alone or together, help to identify foreign funds that are sufficiently similar to RICs? Why or why not? Is the reference to a "distribution" (as defined in § __.4(a)(3) of the 2013 final rule) effective? Should the Agencies modify the reference to a "distribution" to address instances in which a fund's ownership interests generally are sold to retail investors in secondary market transactions, as with exchange-traded funds, for example? Should the definition of "public offering" also take into account whether a fund's interests are listed on an exchange?

Requirement (ii) above is one that U.S. RICs generally do not meet when conducting a U.S. public offering, once you take into account how suitability requirements are required to be applied by broker-dealers that conduct the offering and how in practice suitability requirements operate. More broadly, US RICs are not required to conduct public offerings, and avoiding a public offering is necessary but not sufficient for a private fund

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[163]**See 2013 final rule § __.10(c)(1)(iii).**

to rely on the Sections 3(c)(1) and 3(c)(7) exemptions from the 1940 Act. And, the focus on what is a "public offering," misses the point of what "similarities" to a traditional private equity fund or hedge fund the agencies, and the Volcker Implementing Rules, should be looking at. It is not about the legal conditions to the exemption from the 1940 Act on which funds rely. It is about the characteristics of the fund itself. Is the foreign fund comprehensive regulated? Does it make substantial use of leverage? Does it take control positions in private companies that are not early stage companies? Does the foreign fund make significant use of derivatives, short-selling and arbitrage strategies? If the answer to the first question is "yes", or if the answers to the second, third and fourth questions are "no," the foreign fund is not "similar" to a private equity fund or hedge fund and should not be included in the definition of "covered fund."

Question 149. The public offering definition provides in part that the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets. Are there jurisdictions that permit offerings that would otherwise meet the definition of a public offering but that restrict availability to investors having a minimum level of net worth or net investment assets or that otherwise restrict the types of investors who can participate?

Yes. The United States is a jurisdiction that imposes requirements on who can invest in a public offering based on net worth and closely related criteria. *See* FINRA Rule 2111; SEC Proposed Regulation BI; discussion above at pages 8-10.

Conversely, should the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States? Would a foreign fund that actually sells ownership interests in public offerings outside of the United States tend to provide greater information to the public or be subject to additional regulatory requirements than a fund that is authorized to conduct a public offering but offers and sells its ownership interests in non-public offerings?

No. Domestic registered investment companies are not required to conduct a public offering to register with the SEC under the 1940 Act or to be excluded from the Volcker Rule definition of "covered fund." Moreover, the current Volcker Implementing Rules narrowly define "public offering" in a way that many U.S. mutual funds would not meet, if one takes into account the suitability requirements that apply to their offerings. This

requirement creates disparity between the treatment of domestic and foreign investment companies under the Volcker Rule.

Question 150. If the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States, should the Agencies retain the requirement that the fund's ownership interests must be sold "predominantly" through one or more such offerings? Why or why not? As mentioned above, the Agencies stated in the preamble to the 2013 final rule that they generally expect a fund's offering would satisfy this requirement if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States. Has this guidance been helpful in identifying FPFs that should be excluded, if the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States?

As discussed above, the focus on whether the foreign fund conducts a public offering is fundamentally a misguided approach. The 85 percent test is a condition imposed in an attempt to prevent evasion of the public offering requirement, which itself is an attempt to prevent the use of a foreign fund that does not globally rely on Sections 3(c)(1) or 3(c)(7) to evade the definition in the statute of "hedge fund" and "private equity fund". It is a penumbra around a frolic and detour and shows how far this approach has drifted from the statutory text, the legislative history and the FSOC recommendations. It does not in any way relate to a test of whether the fund shares the characteristics of a traditional private equity fund or hedge fund. It would be a much better reading of the statute to exclude comprehensively regulated foreign funds from the definition of "covered funds."

Question 151. The Agencies understand that some banking entities have faced compliance challenges in determining whether 85 percent or more of the fund's interests are sold to investors that are not residents of the United States. Where foreign funds are listed on a foreign exchange, for example, it may not be feasible to obtain sufficient information about a fund's owners to make these determinations. The Agencies understand that banking entities also have experienced difficulties in obtaining sufficient information about a fund's owners in some cases where the foreign fund is sold through intermediaries. What sorts of compliance and other costs have banking entities incurred in developing and maintaining compliance systems to track foreign public funds' compliance with this condition? To the extent that

commenters have experienced these or other compliance challenges, how have commenters addressed them? Have funds failed to qualify for the FPF exclusion because of this condition? Which kinds of funds and why? Do commenters believe that these funds should nonetheless be treated as FPFs? Why? If the Agencies retain this condition, should they reduce the required percentage of a fund's ownership interests that must be sold to investors that are not residents of the United States? Which percentage would be appropriate? Should the percentage be more than 50 percent, for example? Would a lower percentage mitigate the compliance challenges discussed above? If the Agencies do not retain the condition that an FPF must be sold predominantly through one or more public offerings outside of the United States, should the Agencies impose any limitations on the extent to which the fund can be offered in private offerings in the United States?

See response to question 150.

Question 152. The 2013 final rule places an additional condition on a U.S. banking entity's ability to rely on the FPF exclusion with respect to any FPF it sponsors: the fund's ownership interests must be sold predominantly to persons other than the sponsoring banking entity and certain persons connected to that banking entity. Has this additional condition been effective in identifying FPFs that should be excluded from the covered fund definition? Has it been effective in permitting U.S. banking entities to continue their asset management businesses outside of the United States while also limiting the opportunity for evasion of section 13? Conversely, has this additional condition resulted in the compliance challenges discussed above in connection with the Agencies' view that a fund generally is sold "predominantly" in public offerings outside of the United States if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States? The Agencies understand that determining whether the employees and directors of a banking entity and its affiliates have invested in a foreign fund has been particularly challenging for banking entities because

the 2013 final rule defines the term "employee" to include a member of the immediate family of the employee.[164]

Is there a more direct way to define the term "employee" to mitigate the compliance challenges but still be effective in limiting the opportunity for evasion of section 13? If so, how? Should a revised definition specify who is included in an employee's immediate family for this purpose? Should a revised definition exclude immediate family members? If so, why?

See response to question 150.

Question 153. What other aspects of the conditions for FPFs have resulted in compliance challenges? Has the condition that FPFs be sold predominantly through public offerings outside of the United States resulted in U.S. banking entities, including their foreign affiliates and subsidiaries, determining not to sponsor new FPFs because of concerns about compliance challenges and costs? If the Agencies retain this additional condition, should they reduce the required percentage of a fund's ownership interests sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity? Which percentage would be appropriate? Would a lower percentage mitigate the compliance challenges discussed above? Are there other conditions that might better serve the same purpose but reduce the challenges presented by this condition? One effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but can own up to 25 percent of a RIC after the seeding period.[165]

See response to question 150.

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[164] **See 2013 final rule § __.2(j)**

[165] **The limitation on a banking entity's investment in a U.S. registered fund under the 2013 final rule results from the definition of "banking entity." If a banking entity owns, controls, or has power to vote 25 percent or more of any class of voting securities of another company, including a U.S. registered fund after a seeding period, that other company will itself be a banking entity under the 2013 final rule.**

Is this disparate treatment appropriate? Another effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but a foreign banking entity can own up to 25 percent of an FPF that it sponsors. Is this disparate treatment appropriate?

This disparate treatment is not appropriate. The expansion of the term "covered funds" to include all foreign funds absent an exemption is contrary to the plain language of the statute and the very clearly stated intent of Congress. It is not consistent with the recommendations of FSOC's 2011 report. It is not consistent with principles of comity and level playing field. The obvious way to approach the issue is to exclude all comprehensively regulated foreign funds from the definition of "covered funds" without reference to whether, in what fashion, or where, they conduct a public offering of their securities.