sifma

Invested in America

December 13, 2019

By electronic submission

Re: Supplemental Comment Letter on the Notice of Proposed Rulemaking Revising the 2013 Final Rule Implementing Section 13 of the BHC Act (the "**Volcker Rule**")

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] is writing this supplemental comment letter on the covered funds portion of the Proposal[2] in order to elaborate on why the Agencies[3] implementing Section 13 of the Bank Holding Company Act of 1956 (the "**BHC Act**"), otherwise known as the Volcker Rule, clearly have the authority to revise the regulations issued by the Agencies in December 2013 (the "**2013 Final Rule**") to:

- exclude from the term "covered fund" the additional issuers proposed to be excluded in our comment letter dated October 17, 2018 (our "**2018 Comment Letter**") pursuant to the tailoring authority in subsection (h)(2) of the statute; or

- treat as permitted activities pursuant to subsection (d)(1)(J) of the statute any investment in, sponsorship of or covered transaction with any of the additional issuers proposed to be excluded from the term "covered fund" in our 2018 Comment Letter.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("**GFMA**"). For more information, visit http://www.sifma.org.

[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 "**Proposal**"). The rule identifiers are FRB Docket No. R-1608 & RIN 7100-AF 06; CFTC RIN 3038-AE72; FDIC RIN 3064-AE67; OCC Docket ID OCC-2018-0010 & RIN 1577-AE27; and SEC Release No. BHCA-3 & File No. S7-14-18.

[3] The Agencies are the Board of Governors of the Federal System ("**Federal Reserve**"), the Commodity Futures Trading Commission ("**CFTC**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Office of the Comptroller of the Currency ("**OCC**") and the Securities and Exchange Commission ("**SEC**").

I. Additional Excluded Issuers Under Tailoring Authority

The Agencies clearly have the authority to exclude any issuer from the term "covered fund" pursuant to the tailoring authority in subsection (h)(2) of the statute, as long as the exclusion is consistent with the purposes of the statute.[4] As the Agencies first explained in the preamble to the 2013 Final Rule, subsection (h)(2) "contains two parts: a first part that refers to any issuer that is 'an investment company, as defined in the Investment Company Act, but for section 3(c)(1) and 3(c)(7) of the Act'; and a second part that covers 'such similar funds as the [Agencies] may, by rule . . . determine."[5] While acknowledging that it was possible to read the tailoring authority in the second part of the provision as modifying only the term "similar funds," and therefore only authorizing the Agencies to augment the definition, the Agencies noted that "commentators argued that this interpretation led to unintended consequences that were not consistent with other provisions of [the statute], and that other interpretations . . . were more consistent with both the words and the purpose of the statute."[6] The Agencies concluded that "[b]ased on the interpretive and policy considerations raised by commenters, the language of section 13(h)(2), and the language, structure, and purpose of the Dodd-Frank Act,"[7] the tailoring authority "can best be interpreted" to modify both the first and second parts of subsection (h)(2), thereby authorizing the Agencies to both augment and grant exclusions from the general definition.[8]

The Agencies relied on this interpretation of the tailoring authority to exclude thirteen types of issuers from the general definition of "covered fund" in the 2013 Final Rule[9] and create a fourteenth provision that recognizes the authority of the Agencies to exclude additional issuers by joint determination if consistent with the purposes of the statute.[10] According to the preamble to the 2013 Final Rule, the purpose of these exclusions was "to focus the covered fund definition on vehicles used for the investment

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[4] *See* 12 U.S.C. § 1851(h)(2).

[5] *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds: Final Rule*, 79 Fed. Reg. 5536, 5670 (January 31, 2014).

[6] *Id.*

[7] *Id.* at 5671. *See also id.*, note 1683 ("The Agencies believe that the choice of the tailored definition is supported by the legislative history that suggests Congress may have foreseen that its base definition could lead to unintended results and might be overly broad, too narrow, or otherwise off the mark."); Proposal, 83 Fed. Reg. at 33471 and note 150 ("In the preamble to the 2013 final rule, the Agencies stated their belief that the definition was consistent with the words, structure, purpose, and legislative history of section 13 of the BHC Act. . . . Tailoring the scope of the definition was intended to allow the Agencies to avoid any unintended results that might follow from a definition that was inappropriately imprecise.").

[8] 79 Fed. Reg. at 5670.

[9] §__.10(c)(1)–(13), 79 Fed. Reg. at 5788–89.

[10] §__.10(c)(14), 79 Fed. Reg. at 5789–90.

purposes that were the target of section 13."[11] The Agencies also relied on this interpretation of the tailoring authority to augment the covered fund definition to "address foreign fund structures and certain commodity pools that might otherwise allow circumvention of the restrictions of section 13."[12]

This interpretation of the tailoring authority is entitled to deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[13] because the wording of subsection (h)(2) is ambiguous as to whether the tailoring provision modifies "similar funds" alone or also modifies the general definition and because the Agencies' conclusion that it modifies both provisions is reasonable in light of the language and purposes of the statute.[14] Annex A provides an overview of the *Chevron* doctrine, including the application of that doctrine to an agency's rescission or modification of prior rulemakings, and discusses the current state of jurisprudence regarding the application of *Chevron* to statutes like the Volcker Rule that delegate interpretive authority to multiple agencies.

All of the proposed exclusions in our comment letter are consistent with the purposes of the covered funds portion of the statute. As explained more fully in our 2018 Comment Letter (relevant pages attached as Annex B hereto), the purposes of the covered funds portion of the statute are to prevent banking entities from (i) engaging in proprietary trading indirectly through hedge funds or private equity funds to the extent they would be prohibited or restricted from engaging in proprietary trading directly ("**anti-evasion purpose**"); (ii) guaranteeing the performance of or otherwise bailing out the investors of any covered funds they sponsor, organize and offer, or invest in and advise ("**anti-bailout purpose**"); and (iii) having conflicts of interest with their clients, while at the same time continuing to permit banking entities to make safe and sound investments indirectly through fund structures, which are in the public interest ("**safety and soundness purpose**").

The proposed exclusions would all be consistent with these purposes because, among other conditions, each exclusion would be subject to the conditions that (i) the excluded issuer would not engage in any proprietary trading whatsoever, (ii) no banking entity that sponsors, organizes and offers, invests in or advises the excluded issuer would guarantee the performance of or otherwise bail out the investors of the excluded issuer

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[11] *Id.* at 5671. *See also* Proposal, 83 Fed. Reg. at 33471 ("In the 2013 final rule, the Agencies adopted a tailored definition of 'covered fund' . . . with exclusions for certain types of issuers" that were designed "to focus the covered fund definition on vehicles used for investment purposes that the Agencies believed were the target of section 13 of the BHC Act.").

[12] 79 Fed. Reg. at 5671.

[13] 467 U.S. 837 (1984).

[14] *Id.* at 842–83.

and (iii) the excluded issuer would make all investments in compliance with safety and soundness standards (including with respect to conflicts of interest with clients) substantially similar to those that would apply if a banking entity made the investments directly.

Our proposed exclusions would only carve out a relatively small portion of the issuers that would otherwise be considered covered funds under the 2013 Final Rule. In particular, the following issuers would remain covered funds even if the additional exclusions proposed in our 2018 Comment Letter are granted because they would fail to satisfy one or more of the conditions of the proposed additional exclusions:

- *Hedge Funds*. All hedge funds that engage in any proprietary trading whatsoever (virtually all hedge funds).

- *Funds of Hedge Funds*. All funds that invest in third-party hedge funds that engage in any proprietary trading whatsoever (virtually all hedge funds).

- *PE Funds Engaged in Any Proprietary Trading*. All private equity ("**PE**") funds that engage in any proprietary trading. E.g., tactical opportunity funds, special situations funds, distressed funds.

- *PE Funds with Any FHC-Ineligible Investments*. All PE funds that make any investments or engage in any activities that a financial holding company ("**FHC**") is not permitted to make or engage in directly. E.g., portfolio companies held longer than the maximum holding period under the merchant banking rule (generally 10 years), participating in the day-to-day management of any portfolio company, direct investments in real estate or buildings (rather than through limited liability companies), or engaging in the management of real estate properties (whether or not held through limited liability companies).

- *PE Funds that Hold Investments for Less than 2 Years*. All PE funds that hold investments for less than two years, absent unusual circumstances for early disposal such as a safety and soundness reason. E.g., tactical opportunity funds, special situations funds, distressed funds.

- *Guaranteed Funds*. All PE funds where any banking entity that sponsors, organizes and offers, invests in, or advises the funds directly or indirectly guarantees performance of the funds.

- *PE Funds that Do Not Comply with Safety and Soundness Standards*. All PE funds that make investments that would not be consistent with safety and soundness standards substantially similar to those applicable to investments made by a banking entity directly.

- *Third-Party PE Funds Where Any Condition Not Satisfied.* Any PE fund sponsored, organized and offered, advised or invested in by an unaffiliated third party, unless the fund satisfies all of the conditions to be a qualifying long-term investment fund or another exclusion.

Moreover, we do not believe that the tailoring authority is constrained by the ordinary meaning of the term private equity fund for the reasons set forth in our 2018 Comment Letter (relevant pages attached as Annex C hereto). In particular, we believe that the language of the tailoring authority is broad enough to authorize exclusions from both the technical definition of the term private equity fund contained in the statute[15] and any ordinary meaning of the term to the extent any such ordinary meaning exists.[16] Indeed, several types of private equity funds are already excluded from the definition of covered fund under the exclusions that the Agencies adopted in the 2013 Final Rule,[17] which the additional proposed exclusions in our 2018 Comment Letter would not change.

II. Permissible Investments Under Subsection (d)(1)(J)

Alternatively, the Agencies have the authority to treat as permitted activities pursuant to subsection (d)(1)(J) of the statute any investment in, sponsorship of or covered transaction with any of the additional issuers proposed to be excluded from the term "covered fund" in our 2018 Comment Letter, if they determine that such permitted

[15] 12 U.S.C. § 1851(h)(2).

[16] If the Agencies decided it would be in the public interest to allow banking entities to make non-controlling investments under Section 4(c)(6) of the BHC Act in long-term investment funds that are sponsored by third parties that are not banking entities and that therefore would not necessarily satisfy the first condition of our proposed definition for "qualifying long-term investment funds," the Agencies could drop the first condition of that proposed definition with respect to such non-controlling investments in such otherwise qualifying third-party funds. Section 4(c)(6) of the BHC Act, codified at 12 U.S.C. § 1843(c)(6), permits a bank holding company to make non-controlling investments in up to 4.9% of any class of voting securities of another company.

[17] For example, by excluding from the definition of covered fund an issuer that may rely on an exclusion or exemption from the definition of "investment company" under the Investment Company Act of 1940 other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act, the 2013 Final Rule excludes from the definition of covered fund (i) real estate funds excluded from the definition of "investment company" under section 3(c)(5)(C) of the Investment Company Act of 1940, (ii) oil and gas funds excluded under section 3(c)(9) of the Investment Company Act of 1940, (iii) securitization funds excluded under SEC Rule 3a-7 under the Investment Company Act of 1940 and (iv) employees' security companies excluded under section 6(b) of the Investment Company Act of 1940. The 2013 Final Rule also excludes from the definition of covered fund (v) companies that have elected to be treated as business development companies under 15 U.S.C. § 80a-53, (vi) public welfare funds making investments of the type permitted under the National Bank Act, 12 U.S.C. § 24 (Eleventh) and (vii) loan funds qualifying for the loan securitization exclusion. *See* §__.10(c)(8), (11)(2)(A), (12)(ii), (12)(iii), 79 Fed. Reg. at 5788–89.

activities "would promote and protect the safety and soundness of the banking entity and the financial stability of the United States."[18]

The legislative history of the Volcker Rule supports the view that Congress intended for Section (d)(1)(J) to authorize the Agencies to treat certain activities as permitted activities, provided that the Agencies determine that such activities are properly conducted and would, if permitted, otherwise promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

For example, in a colloquy between one of the named sponsors of the Dodd-Frank Act—Senate Banking Committee Chairman Christopher Dodd (D-CT)—and Senator Barbara Boxer (D-CA), another member of Congress who voted in favor of the Volcker Rule, Senator Boxer wanted confirmation that the Agencies would have the authority to grant "permitted activities" exemptions for properly conducted investments by banking entities in venture capital funds. Chairman Dodd confirmed that Section (d)(1)(J) authorized the Agencies to granted "permitted activities" exemptions for "properly conducted" investments in venture capital funds because such an exemption would satisfy the safety and soundness and financial stability conditions of Section (d)(1)(J):

> "**Mrs. Boxer**. Mr. President, I wish to ask my good friend, the Senator from Connecticut and the chairman of the Banking Committee, to engage in a brief discussion relating to the final Volcker rule and the role of venture capital in creating jobs and growing companies. . . . I know the chairman recognizes, as we all do, the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies. I also know the authors of this bill do not intend the Volcker rule to cut off sources of capital for America's technology startups, particularly in this difficult economy. . . . I believe the intent of the rule is not to harm venture capital investment. Is my understanding correct?
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> "**Mr. Dodd**. Mr. President, I thank my friend, the Senator from California, for her support and for all the work we have done together on this important issue. Her understanding is correct.
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> ". . . [P]roperly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section

[18] 12 U.S.C. § 1851(d)(1)(J).

619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619[d][1](J)."[19]

Congress reinforced the congressional intent reflected by this legislative history by enacting the small banking entity exclusion from the Volcker Rule in Section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("**EGRRCPA**").[20] The small banking entity exclusion effectively permits small banking entities to invest in any covered fund, including any third-party fund. Presumably, Congress found that such investments are consistent with the safety and soundness of the small banking entities, the financial stability of the United States and the broader public interest.

Permitting banking entities to engage in such permitted activities with respect to the additional excluded issuers proposed to be excluded from the term "covered fund" in our 2018 Comment Letter, subject to the conditions set forth in our 2018 Comment Letter for such additional issuers, would promote and protect the safety and soundness of these banking entities and the financial stability of the United States by allowing them to diversify their assets and income streams, thereby reducing the overall risk of their assets and operations and increasing their resiliency against failure. In particular, such permitted activities would allow banking entities to diversify their businesses through products that support long-term investment and asset management services and otherwise serve client needs. For example, a permitted activity with respect to qualifying long-term investment vehicles would permit banking entities to engage in the same sort of safe and sound, long-term investment activities indirectly through fund structures that they are expressly permitted to engage in directly, such as merchant banking activities. Allowing banking entities to engage in merchant banking investments through properly structured long-term investment funds would reduce associated risks and enhance banking entities' safety and soundness by allowing banking entities to share the risks of those investments with third parties rather than bear those risks entirely on their own balance sheets. Moreover, a permitted activity with respect to qualifying credit funds would promote lending more broadly, thereby potentially mitigating the threat of runs, and would facilitate client-driven capital formation. Additionally, a permitted activity with respect to qualifying family wealth management vehicles would allow banking entities to offer a full range of services to those vehicles, consistent with the traditional role of banks providing wealth management services. Finally, a permitted activity with respect to qualifying customer facilitation structures would allow banking entities to offer a single

[19] 156 Cong. Reg. S5904–05 (daily ed. July 15, 2010).

[20] The small banking entity exclusion applies to any banking entity that has, and for which any company that controls that banking entity has, $10 billion or less in total consolidated assets and trading assets and liabilities that are 5% or less of its total consolidated assets. 12 U.S.C. § 1851(h)(1); § __.2(r)(2) of the implementing regulations.

customer or group of affiliated customers the option to gain investment exposure to the purchase or sale of financial instruments or other strategies indirectly through the use of a vehicle rather than directly. Such permitted activities could also promote financial innovation and reduce funding costs to help ensure competitive equality between U.S. banking entities and foreign firms.

III. Conclusion

In summary, for the reasons set forth in this supplemental comment letter, including the Annexes hereto, we believe that the Agencies clearly have the authority to:

- exclude from the term "covered fund" the additional issuers proposed to be excluded in our 2018 Comment Letter pursuant to the tailoring authority in subsection (h)(2) of the statute; or

- treat as permitted activities pursuant to subsection (d)(1)(J) of the statute any investment in, sponsorship of or covered transaction with any of the additional issuers proposed to be excluded from the term "covered fund" in our 2018 Comment Letter.

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SIFMA appreciates the opportunity to comment on the Proposal. If you have any questions, please contact Kenneth E. Bentsen, Jr. at [redacted] [redacted]) or Robert Toomey at [redacted] [redacted]).

Respectfully submitted,

Kenneth E. Bentsen, Jr.
President and CEO
SIFMA

cc:

Honorable Jerome H. Powell, Richard H. Clarida, Randal K. Quarles, Michelle W. Bowman, and Lael Brainard, Chairman, Vice Chairman, Vice Chairman for Supervision, and Governors, Board of Governors of the Federal Reserve System

Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation

Honorable Joseph M. Otting, Comptroller of the Currency, Office of the Comptroller of the Currency

Honorable Jay Clayton, Robert J. Jackson, Jr., Hester M. Peirce, Allison Herren Lee, and Elad L. Roisman, Chairman and Commissioners, Securities and Exchange Commission

Honorable Heath P. Tarbert, Rostin Behnam, Dan M. Berkovitz, Brian D. Quintenz, and Dawn DeBerry Stump, Chairman and Commissioners, Commodity Futures Trading Commission

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Annex A to SIFMA Supplemental Comment Letter:

Overview of Doctrine on Agency Authority to Interpret and Implement Statutory Text

A. Chevron Doctrine

The Administrative Procedure Act (the "*APA*") establishes standards that generally apply to judicial review of agency actions. Congress may, by statute, modify the standards for review of agency actions, but in the absence of such statutory modification, the APA provides that a reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . [or] in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[1]

When faced with a challenge to the legitimacy of agency action, courts must interpret the meaning of statutory provisions to determine if the agency's actions accord with its authority under the governing statute. To conduct this inquiry, courts apply the two-step framework outlined by the Supreme Court in *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*[2]

Under the first step of the *Chevron* analysis, a reviewing court must determine whether, after employing traditional tools of statutory construction,[3] Congress "has directly spoken to the precise question at issue."[4] If so, then a contrary agency interpretation is not entitled to deference. Instead, the agency "must give effect to the unambiguously expressed intent of Congress."[5] In other words, for the analysis to proceed to the second step under *Chevron*, a reviewing court must determine that Congress left a gap in the statute's meaning, either because Congress "inadvertently did not resolve, or intentionally left to be resolved in light of everyday realities" the interpretive question.[6]

[1] 5 U.S.C. § 706(2). The APA further provides that a reviewing court may also set aside agency action on the basis that the action is "(B) contrary to constitutional right, power, privilege, or immunity; . . . (D) without observance of procedure required by law; (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title [*procedures governing hearings before administrative courts and certain other agency proceedings*] or otherwise reviewed on the record of an agency hearing provided by statute; or (F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court," among other bases. 5 U.S.C. § 706(2).

[2] 467 U.S. 837 (1984). The Supreme Court held in *United States* v. *Mead Corp.*, 533 U.S. 218 (2001), that *Chevron* deference only applies if the court finds that the agency interpretation at issue was made pursuant to a Congressional delegation of authority "to make rules carrying the force of law." In the Volcker Rule, Congress expressly delegated to the Agencies authority to promulgate regulations implementing the statutory text and enforce those regulations. *See* Dodd-Frank Act §§ 619(b)(2) & (e)(2).

[3] *Chevron*, 467 U.S. at 843 n.9.

[4] *Id.* at 842.

[5] *Id.* at 842–43.

[6] *Id.* at 865–66.

If the analysis proceeds to the second step, the reviewing court must ask whether the agency's interpretation of the statutory question is "based on a permissible construction of the statute"—that is, whether the agency interpretation is "reasonable" in light of the statutory text.[7]

Further, courts and commentators have generally understood *Chevron*'s second step to require that the agency's interpretive choice be the product of reasoned decision making, consistent with the "arbitrary and capricious" standard codified in the APA.[8] An agency would therefore fail to meet *Chevron*'s second step if it arrived at a reasonable interpretation of an ambiguous statute, but did so for arbitrary and capricious reasons.[9] As the Court held in *State Farm*, a reviewing court may not set aside an agency modification or rescission so long as it is "rational, based on consideration of the relevant factors, and within the scope of the authority delegated to the agency by statute" and the

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[7] *Id.* at 843.

[8] 5 U.S.C. § 706(2). *See, e.g.*, *Judulang* v. *Holder*, 132 S. Ct. 476, 483 n.7 (2011) ("[U]nder *Chevron* step two, we ask whether an agency interpretation is 'arbitrary or capricious in substance.'") (citation omitted) (internal quotation marks omitted); *AT&T Corp.* v. *Iowa Utils. Bd.*, 525 U.S. 366, 391–92 (1999); *Chamber of Commerce of the U.S.* v. *FEC*, 76 F.3d 1234, 1235 (D.C. Cir. 1996) ("[T]he second step of *Chevron* . . . overlaps with the arbitrary and capricious standard.").

[9] *Chevron* at 844. *See also Motor Vehicle Mfrs. Ass'n of U.S., Inc.* v. *State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) ("Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, [or] entirely failed to consider an important aspect of the problem . . . ."); Kenneth A. Bamberger & Peter L. Strauss, Chevron*'s Two Steps*, 95 VA. L. REV. 611, 613 (2009) (distinguishing between "the 'interpretive question' (involving the permissibility of an agency construction in light of statutory language) and the 'decisionmaking question' (regarding the reasonableness of the process by which a permissible construction was reached)").

Examples of defects in agency decision making that have resulted in findings that an agency action was arbitrary and capricious include the following: (i) failing to consider a relevant and important factor in making a decision (*Dep't of State* v. *Coombs*, 482 F.3d 577, 581 (D.C. Cir. 2007)); (ii) failing to consider circumstances that "warrant different treatment for different parties" (*Petroleum Commc'ns, Inc.* v. *FCC*, 22 F.3d 1164, 1172 (D.C. Cir. 1994)); (iii) relying on factors Congress did not intend for the agency to consider (*State Farm*, 463 U.S. at 43); (iv) providing an explanation that "runs counter" to the evidence before the agency (*State Farm*, 463 U.S. at 43) or reaching a conclusion that contradicts the underlying record (*Tucson Herpetological Soc.* v. *Salazar*, 566 F.3d 870, 879 (9th Cir. 2009)); (v) providing an explanation that is "so implausible that it could not be ascribed to a difference in view or the product of agency expertise" (*State Farm*, 463 U.S. at 43); (vi) taking rulemaking action that undercuts another simultaneous rulemaking by the same agency (*Office of Commc'n of United Church of Christ* v. *FCC*, 707 F.2d 1413, 1441-42 (D.C. Cir. 1983)); (vii) "fail[ing] to provide any coherent explanation for its decision" (*Fox* v. *Clinton*, 684 F.3d 67, 80 (D.C. Cir. 2012)); (viii) issuing a rule that was based on "pure political compromise, not reasoned scientific endeavor" (*Midwater Trawlers Coop.* v. *Dep't of Commerce*, 282 F.3d 710, 720 (9th Cir. 2002)); and (ix) failing to "exercise sufficiently independent judgement" by "ced[ing] near-total deference to private parties' estimates" (*Tex. Office of Pub. Util. Counsel* v. *FCC*, 265 F.3d 313, 327–28 (5th Cir. 2001)).

agency offered an explanation that is plausible and consistent with the evidence before it.[10]

The Court in *Chevron* stated that "[i]f Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute."[11]

B. Application of Chevron to Agency Modification of Prior Interpretations and Rulemakings

The *Chevron* doctrine permits an agency to change its interpretation of a statute over time, provided that its new interpretation is a reasonable construction of the statute.[12] The Supreme Court held in *State Farm* that the same standards of review apply whether an agency is promulgating new regulations or modifying or rescinding existing regulations.[13] Thus, judicial review of agency modifications and rescissions of regulations applies the same standard that is applied to agency promulgations of new regulations.

Specifically, where "an agency [is] changing its course by rescinding a rule," the agency "is obligated to supply a reasoned analysis for the change."[14] As part of this analysis, the agency "must examine the relevant data and articulate a satisfactory

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[10] *See also Motor Vehicles Mfrs. Ass'n of U.S., Inc. v. State Farm Mutual Auto Ins. Co.*, 463 U.S. 29, 42 (1983).

[11] *Chevron*, 467 U.S. at 843–44.

[12] *See FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 514 (2009) (holding that a "more searching review" is not necessarily appropriate simply because an agency changed its interpretation of the governing statute). *See also Rust* v. *Sullivan*, 500 U.S. 173, 186–87 (1991); *Independent Bankers Ass'n* v. *Farm Credit Admin.*, 164 F.3d 661, 668 (D.C. Cir. 1999).

[13] *State Farm*, 463 U.S. at 41. The Court has also held that interpretive inconsistency over time is not directly relevant to the *Chevron* analysis, but could, if not adequately explained, result in an agency's decision making being deemed to be arbitrary and capricious under the standard articulated in *State Farm*. *See Nat'l Cable & Telecomms. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 981 (2005).

[14] *State Farm*, 463 U.S. at 42. If the court had equated agency rescissions to decisions not to act, an agency's decision to rescind a regulation would be essentially unreviewable. *See* Scott A. Keller, *Depoliticizing Judicial Review of Agency Rulemaking*, 84 WASH. L. REV. 419, 444–45 (2009) ("State Farm nixed the argument that deregulation should be treated like agency inaction, which would have made deregulation basically unreviewable.").

explanation for its action including a 'rational connection between the facts found and the choice made.'"[15]

The Court indicated in *State Farm* that an agency's "substantial uncertainty" that a regulation would achieve its purpose would be a sufficient reason for an agency to rescind a regulation (or decline to promulgate a regulation in the first place), so long as that uncertainty is "supported by the record and reasonably explained."[16]

The Court also endorsed cost-benefit analysis as a method of agency decision making that would withstand the arbitrary and capricious standard of review.[17] Further, the Court stated that an agency may properly make a decision to rescind a regulation based on an agency's policy judgment and without concrete data.[18]

C. Application of Chevron to Multi-Agency Statutes

As numerous commentators have observed following the enactment of the Dodd-Frank Act, Congress's decision to delegate implementation authority for provisions of that Act (including the Volcker Rule) to multiple supervisory agencies poses unique challenges to statutory implementation.[19] To date, the Supreme Court has not expressly stated that *Chevron* deference should be accorded to an interpretation of a statute promulgated jointly by multiple agencies. It is therefore unclear how courts will review joint or coordinated rulemakings under the Dodd-Frank Act, including any revision to the Final Rule.

[15] *State Farm*, 463 U.S. at 43 (citing *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962)).

[16] *Id.* at 52.

[17] *Id.* at 54.

[18] *Id.*

[19] *See* William Weaver, Note, *Multiple-Agency Delegations & One-Agency* Chevron, 67 VAND. L. REV. 275, 299 (2014) ("Whatever the precise nature of jurisdictional overlap and whether the benefits are advanced by increased coordination, joint rules pose a unique challenge for courts applying the one-agency framework from Chevron."). *See also* John F. Cooney, Chevron *Deference and the Dodd-Frank Act*, 37 ADMIN. & REG. L. NEWS, Spring 2012, at 1 (noting that, throughout the Dodd-Frank Act, "Congress repeatedly declined to give any one agency primacy in implementation of a statutory provision. Rather, it granted equal authority to multiple agencies, each of which was directed to issue joint regulations carrying out ambiguous statutory provisions, and it empowered each of them to apply those rules separately to the specific types of institutions subject to its jurisdiction"). *See also* Curtis W. Copeland, Cong. Research Serv., R41380, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Regulations to Be Issued by the Consumer Financial Protection Bureau* 28, 29, 36 (2010) (listing Dodd-Frank Act provisions that provide for joint rulemaking).

(i) *Current State of Jurisprudence*

Under pre-*Chevron* case law, courts occasionally cited the fact that multiple agencies interpreted and administered a statute as a factor for withholding or reducing the deference given to an agency's interpretation.[20] It continues to be the case that courts typically do not award *Chevron* deference to interpretations of statutes of general applicability, such as the Freedom of Information Act or the National Environmental Protection Act, which do not grant implementation authority to any particular agency and are administered by many agencies across a broad range of policy areas.[21]

In post-*Chevron* cases where the authorizing statute is not a statute of general applicability (as is true of the Volcker Rule), courts have had to consider difficult questions regarding whether *Chevron* deference should be afforded in circumstances where multiple agencies are delegated authority to implement a statute. Some circuits have declined to accord the full weight of *Chevron* deference to agency interpretations of multi-agency statutes.

In the D.C. Circuit, for example, if multiple agencies are charged with administering a statute, an agency's interpretation is generally not entitled to *Chevron* deference where there is an actual or potential conflict between different agencies' interpretations[22] or in the context of a statute where multiple agencies have specialized enforcement responsibilities, but there exists a risk of inconsistent enforcement or uncertainty in the law because the agencies' authorities overlap.[23] Courts in the Second and Third Circuits have taken similar positions in recent years.[24]

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[20] *See, e.g.*, *N. Haven Bd. of Educ.* v. *Bell*, 456 U.S. 512, 522 n.12 (1982); *Gen. Electric Co.* v. *Gilbert*, 429 U.S. 125, 144–45 (1976).

[21] *See, e.g.*, *Grand Canyon Trust* v. *FAA*, 290 F.3d 339, 341-42 (D.C. Cir. 2002) (holding that "the court owes no deference" to an agency's interpretation of the National Environmental Protection Act because that law was addressed to all federal agencies and not to one agency alone); *Sherley* v. *Sebelius*, 689 F.3d 776, 786 (D.C. Cir. 2012), cert. denied, 133 S. Ct. 847 (2013). *See also* Thomas W. Merrill & Kristin E. Hickman, Chevron*'s Domain*, 89 GEO. L.J. 833, 894 (2001).

[22] *See Caiola* v. *Carroll*, 851 F.2d 395, 399 (D.C. Cir. 1988) (finding deference to the agency's interpretation of its own regulation inappropriate because the regulation was written and promulgated by multiple agencies, and the "possibility of inconsistent interpretations . . . weaken[s] the case for deference"); *Rapaport* v. *U.S. Dep't of Treasury*, 59 F.3d 212, 216–17 (D.C. Cir. 1995) (stating that an inter-agency conflict may arise where "the same statute is interpreted differently by the several agencies or the one agency that happens to reach the courthouse first is allowed to fix the meaning of the text for all").

[23] See *Collins* v. *Nat'l Transp. Safety Bd.*, 351 F.3d 1246, 1253 (D.C. Cir. 2003).

[24] *Chao* v. *Cmty. Trust Co*., 474 F.3d 75, 85 (3d Cir. 2007) ("The mere fact that there could be conflicting regulations should preclude *Chevron* deference."); *see also Lieberman* v. *FTC*, 771 F.2d 32, 37 (2d Cir. 1985) ("[W]here . . . Congress has entrusted more than one federal agency with the administration of a statute . . . a reviewing court does not . . . owe as much deference as it might otherwise give if the interpretation were made by a single agency similarly entrusted with powers of interpretation.").

The state of jurisprudence on this question has yet to be fully settled, however, as the Supreme Court has not directly addressed whether multiple agencies could exercise interpretive authority as a unit and be entitled to deference on a joint basis. Where the Court has considered a multi-agency interpretation that was unanimous, the existence of a consensus among the agencies invested with interpretive authority has seemingly factored into the Court's analysis, but the Court has not directly addressed the *Chevron* question and has not expressly adjusted its standards of review to acknowledge agency coordination in rulemaking.

In *Bragdon* v. *Abbott*,[25] the Court considered whether certain types of infections constituted a "disability" under the Americans with Disabilities Act. The Court declined to determine whether the Act's split-implementation mechanism provided a basis to withhold *Chevron* deference from the interpretations of the various agencies that had construed the term. Rather, the Court found that, because the definition of "disability" had been carried forward from a prior statute and all interested agencies interpreted the term as applying to the type of condition at issue, the uniformity of administrative interpretations provided a sufficient basis to uphold those interpretations. One reading of *Bragdon* is that a reviewing court should, at a minimum, accord *Skidmore* deference where multiple agencies are authorized to interpret a statute and are unanimous in their respective interpretations.[26]

In *Coeur Alaska, Inc.* v. *Southeast Alaska Conservation Council*, the Court analyzed a jointly issued regulation as if it had been issued solely by one of the agencies and did not expressly assign weight in the deference inquiry to the fact that the agencies involved had issued the regulation together and were aligned in their interpretive positions.[27]

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[25] 524 U.S. 624 (1998).

[26] *Id.* at 642 ("Every agency to consider the [interpretive] issue under the Rehabilitation Act found statutory coverage for persons with asymptomatic HIV. Responsibility for administering the Rehabilitation Act was not delegated to a single agency, but we need not pause to inquire whether this causes us to withhold deference to agency interpretations under [*Chevron*]. It is enough to observe that the well-reasoned views of the agencies implementing a statute 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance.'" (quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 139–40 (1944))).

[27] 557 U.S. 261, 275 (2011). In cases where the Court has been confronted with inconsistent agency interpretations, the Court has typically sought to discern a basis on which it could conclude that Congress had intended to delegate to one agency predominant authority to implement the specific statutory provision at issue. *See, e.g.*, *Martin* v. *Occupational Safety and Health Review Comm'n*, 499 U.S. 144 (1991) (examining the structure and history of the Occupational Safety and Health Act to accord deference to interpretations of the Department of Labor Occupational Safety and Health Administration, which conflicted with interpretations of the Occupational Safety and Health Review Commission). It is unclear whether this approach would be applied in the context of a challenge to administrative interpretation of the Volcker Rule, given the overlapping implementation authority that Congress delegated to the Agencies.

(ii) *Application to Volcker Rule*

As one commentator on the Dodd-Frank Act has observed, in addressing a challenge to a consensus interpretation of the Act that is reflected in a joint rulemaking of multiple Agencies, "courts likely will follow the approach taken in *Bragdon* and defer to the unanimous view of the agencies involved."[28]

Commentary on trends in administrative law more broadly has suggested that agency rules promulgated jointly after inter-agency consultation would be likely to receive deference under *Chevron* and should, as a normative matter, be viewed by courts with a level of deference that is at least equivalent to—if not even higher than—the deference that is typically accorded to a single agency's interpretation of a statute that does not provide for shared authority among multiple agencies.

In circumstances where agencies have "undergone an extensive process to produce a unified regulatory program" through coordination and consensus-building, there is a "good chance that the process will improve the quality of the resulting decision and thus will be more likely to survive arbitrary and capricious review, including 'hard look' review."[29] Regulatory implementation that harmonizes potential inconsistencies, reduces duplication and reflects a consideration of multiple agencies' expertise and perspectives should, in the view of these commentators, have a better chance of being upheld.

Commentators have also pointed out that the two primary rationales underlying *Chevron* deference—agency expertise and political accountability[30]—both counsel in favor of deference to coordinated rulemaking by multiple agencies and, arguably, apply

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[28] John F. Cooney, Chevron *Deference and the Dodd-Frank Act*, 37 ADMIN. & REG. L. NEWS, Spring 2012, at 9.

[29] Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131, 1184 (2012), at 1204–05 (noting that "[s]tatutorily required consultation and joint policymaking . . . are relatively transparent, visible to principals, and subject to courts' normal oversight function").

[30] *See* Lisa Bressman *et al.*, *The Regulatory State* 2030–33 (2010) (noting that the Court typically considers an agency's policymaking expertise as well as its political accountability when determining questions of Congressional delegation); Evan J. Criddle, Chevron*'s Consensus*, 88 B.U. L. REV. 1271, 1286–89 (2008) (discussing arguments for and against justifying *Chevron* deference based on agency expertise and political accountability); William N. Eskridge, Jr. & Lauren E. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretations From* Chevron *to* Hamdan, 96 GEO. L.J. 1083, 1157 (2008) (finding that the Court has been more deferential when agency expertise was a salient factor in the interpretive process).

with "even more force when Congress carefully designs a regulatory regime that delegates joint-rulemaking authority to coordinated agencies."[31]

Moreover, the Volcker Rule is a statute where Congress has "explicitly left a gap for the agency to fill" with respect to, among other provisions, the definitions of "trading account," "hedge fund" and "private equity fund" and the implementation of the permitted activities. As the *Chevron* court stated, regulations that arise out of an "express delegation of authority to the agency to elucidate a specific provision of the statute by regulation . . . are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute."[32]

We believe that the particular circumstances of the Volcker Rule and the Agencies' rulemaking thereunder are consistent with this line of commentary and, further, do not present the concerns that reviewing courts historically have cited as a basis for declining to accord *Chevron* deference to interpretations promulgated by multiple agencies.

Although the Volcker Rule does not include a general mandate that the Agencies engage in joint rulemaking (unlike certain other provisions of the Dodd-Frank Act[33]), the Volcker Rule includes provisions designed to minimize potentially inconsistent regulations and promote consensus among the Agencies. The Volcker Rule calls for the Agencies to develop and issue implementing regulations in consultation and coordination with one another and in a manner that reduces inconsistency and provides for comparable treatment across regulated entities; assigns rulemaking and enforcement authority with respect to different categories of banking entities to specific Agencies; with respect to insured depository institutions, specifically requires that the implementing regulations be issued "jointly" by the Federal Reserve, OCC and FDIC; and provides for coordination of the implementing regulations by the Chairperson of the FSOC.[34]

To date, the Agencies have given effect to the Volcker Rule's framework for shared jurisdiction by issuing substantively identical regulations and formal guidance and, in almost all cases, acting jointly in connection with such issuances. To the extent

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[31] Weaver, *supra* note 19, at 300–05 (noting that an increase in the number of agencies charged with responsibility for implementation tends to "increase political accountability and salience" and enables the enacting legislature to capitalize on "more and different kinds of agency expertise").

[32] *Chevron*, 467 U.S. at 843–44.

[33] *See, e.g.*, Dodd-Frank Act § 210(c)(8)(H)(i) (requiring the primary financial regulatory agencies to "jointly prescribe regulations requiring that financial companies maintain" certain records with respect to qualified financial contracts); § 712(d)(2)(B) & (C) (requiring the CFTC and SEC, in consultation with the Federal Reserve, to "engage in joint rulemaking to jointly adopt a rule or rules governing" records of security-based swap agreements regarding swap data repositories, swap participants and swap dealers).

[34] *Id.* § 619(b)(2).

that the Agencies continue on this course in any future rulemakings to modify the Final Rule, the case for according deference to the consensus interpretation of the Agencies would be strengthened. Arguably, such a consensus interpretation should be accorded deference even beyond that which is ordinarily accorded to interpretations promulgated by a single administrative agency. In the event that the existing allocation of rulemaking authority under the Volcker Rule is changed—for example, by a designation of the Federal Reserve as the lead Agency for developing rules and interpretive guidance (as multiple commentators have suggested, and which we believe could be achieved through an interagency agreement)—then implementing rules promulgated by the Federal Reserve would be entitled to deference within the well-established framework for applying the *Chevron* doctrine to scenarios where a single agency is charged with authority to interpret a given statute.

The potential that a court would review *de novo* the Agencies' rulemaking based on a perceived risk of inter-agency disagreement could be further mitigated if, for example, the Agencies were to carry out future rulemaking under the Volcker Rule through joint issuances or otherwise in a coordinated manner; issue notices of proposed rulemaking, regulations and other formal guidance that are substantively identical; and otherwise exercise interpretive, enforcement and examination authority in a consistent manner across Agencies and regulated persons.[35]

[35] *But see supra* note 27 (discussing Court's analysis in *Coeur Alaska*).

Annex B to SIFMA Supplemental Comment Letter:

Excerpt from 2018 Comment Letter on the Purposes of the Covered Funds Portion of the Volcker Rule[1]

[1] This Annex reproduces the text of section I.B.1 of Annex B of our 2018 Comment Letter.

We believe that, consistent with their statutory authority, the Agencies should modify certain existing exclusions from the covered fund definition, namely those for foreign public funds and loan securitizations, and create new exclusions for qualifying family wealth management vehicles, qualifying customer facilitation structures, qualifying credit funds, and qualifying long-term investment funds, including venture capital funds. The Agencies clearly have the statutory authority to do so pursuant to the tailoring clause in subsection (h)(2) of Section 13, provided that each such modified or additional exclusion is tailored so as to be consistent with the purposes of the covered fund provisions of Section 13.

The Agencies described that tailoring authority in the Preamble to the 2013 Final Rule as follows:

> The Agencies believe that the language of section 13(h)(2) can best be interpreted to provide two alternative definitions of the entities to be covered by the statutory terms 'hedge fund' and 'private equity fund.' Under this reading, the first part of section 13(h)(2) contains a base definition . . . while the second part grants the Agencies the authority to adopt an alternate definition that is triggered by agency action (the 'tailored definition'). Thus, if the Agencies do not act by rule, the definition is set by reference to the Investment Company Act and the relevant exclusions alone; if the Agencies act by rule, the definitions are set by the Agencies under that rule.[2]

Pursuant to that statutory authority, the Agencies excluded thirteen types of entities from the definition of covered fund.[3] They also included a provision implementing their statutory authority to exclude additional types of entities from the definition of covered fund upon a joint determination that any additional exclusions are consistent with the purposes of Section 13.[4] They did so "to provide certainty, mitigate compliance costs and other burdens, and address the potential over-breadth of the covered fund definition and related requirements without such exclusions by permitting banking entities to invest in and have other relationships with entities that do not relate to the statutory purpose" of Section 13.[5]

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[2] 79 Fed. Reg. at 5670. *See also id*. at 5670–71 (discussing Agencies' statutory authority to adopt exclusions from the definition of covered fund).

[3] 2013 Final Rule § __.10(c)(1) to (13) (providing for 13 exclusions from the definition of covered fund).

[4] 2013 Final Rule § __.10(c)(14) (implementing the tailoring clause of Section 13(h)(2) by providing that "[a]ny issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act" is also excluded from the definition of covered fund).

[5] 79 Fed. Reg. at 5677.

We believe that the Agencies not only have the statutory authority, but, indeed, the public duty to address the remaining overbreadth and undue complexity of the definition of covered fund by further tailoring that definition. This tailoring should be accomplished by modifying certain of the exclusions that are too complex or narrow under the 2013 Final Rule and by adding new exclusions for certain types of entities consistent with the purposes of Section 13. These recommendations would enable banking entities to engage in activities, including asset management, customer facilitation, and certain qualifying long-term investments, that are meant to be preserved by the Volcker Rule and are consistent with the Agencies' statutory authority.

Because the Agencies are permitted to further tailor Section 13 in any manner that is consistent with the purposes of Section 13, it is important to identify the purposes of the covered fund provisions of Section 13. We start with the language of Section 13, which is the best evidence of the purposes of the statute. The language of Section 13 makes clear that Congress intended for Section 13 to be construed in a way that did not inhibit certain covered fund activities of banking entities.

First, the text of Section 13 clearly shows that Section 13 was intended to preserve the ability of banking entities to sponsor and seed registered investment companies ("**RICs**") and entities that are similar to RICs to the extent previously permitted to do so. The statutory prohibition on "acquir[ing] or retain[ing] any equity, partnership or other ownership interest in or sponsor[ing] a hedge fund or a private equity fund" is limited to funds that would be investment companies but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act, or certain "similar funds."[6] Thus, it is consistent with the purposes of the covered fund provisions of Section 13 to exclude from the definition of "covered fund" RICs and entities that are similar to RICs, namely foreign public funds that are subject to disclosure and retail investor protection regulation in one or more jurisdictions.

Second, the text of Section 13 demonstrates that Section 13 was intended to preserve the freedom of banking entities to purchase, sell, acquire or dispose of securities or other financial instruments on behalf of customers. Section 13 includes an exception from the prohibitions of the statute for "[t]he purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers."[7] This exception applies by its terms to all of the statutory prohibitions in subsection (a) of Section 13 and is not limited to the prohibition on proprietary trading and, therefore, it should be available for banking entities when sponsoring or investing in hedge funds or private equity funds on behalf of their customers. Thus, it is consistent with the purposes

[6] 12 U.S.C. § 1851(a)(1)(B); 12 U.S.C. § 1851(h)(2).

[7] 12 U.S.C. § 1851(d)(1)(D).

of the covered fund provisions of Section 13 to exclude from the definition of "covered fund" any vehicles that are specifically designed to facilitate the purchase, sale, acquisition or disposition of securities or other instruments on behalf of customers.

Finally, the text of Section 13 clearly states that Section 13 was not intended to disrupt the sale or securitization of loans. Section 13(g)(2) provides that "[n]othing in this section [13] shall be construed to limit or restrict the ability of a banking entity or a nonbank financial company supervised by the [Federal Reserve] to sell or securitize loans in a manner otherwise permitted by law."[8] It is consistent with the purposes of the covered fund provisions of Section 13 to exclude from the definition of "covered fund" any loan securitization vehicles that were common in the marketplace at the time Section 13 was enacted, including loan securitization vehicles that were permitted to hold a limited basket of debt securities in addition to loans.

To further understand the purposes of the covered fund provisions, it is instructive to look to the principal sponsor of the bill that included Section 13 and ultimately became the Dodd-Frank Act, Senator Christopher Dodd. According to Senator Dodd, the "purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason."[9] Under this formulation, the Agencies have the authority to further tailor the definition of covered fund to preserve safe, sound investment activities that serve the public interest, while continuing to limit bank investment in hedge funds and private equity that amount to excessive risk taking activities.

We next turn to the 2011 study of Section 13 by the Financial Stability Oversight Council ("**FSOC**"). The FSOC stated that the covered funds portion of Section 13 had three purposes:

- "Ensure that banking entities do not invest in or sponsor such funds as a way to circumvent the Volcker Rule's restrictions on proprietary trading;
- Confine the private fund activities of banking entities to customer-related services; and

[8] 12 U.S.C. § 1851(g)(2).

[9] 156 CONG. REC. S5904 (daily ed. July 15, 2010).

- Eliminate incentives and opportunities for banking entities to 'bail out' funds that they sponsor, advise, or where they have a significant investment."[10]

The first and third bullets are consistent with Senator Dodd's statement. The second bullet, however, is inconsistent with Senator Dodd's statement that Section 13 was supposed to "preserv[e] safe, sound investment activities that serve the public interest."[11] To make it consistent with Senator Dodd's statement, it should be read to be limited to organizing and offering covered funds as is contemplated under the so-called asset management exemption under Section 13(d)(1)(G), which is focused on banking entities providing specific types of customer-related services to their clients, and not more broadly to all sponsoring, investing in or entering into covered transactions with covered funds as otherwise described in the statute.

Consistent with Senator Dodd's statements, Federal Reserve Vice Chairman for Supervision Quarles stated that "[t]he fundamental premise of the Volcker rule is simple: banks with access to the federal safety net—Federal Deposit Insurance Corporation insurance and the Federal Reserve discount window—should not engage in risky, speculative trading for their own account."[12] Finally, Federal Reserve Chairman Jerome H. Powell stated that in reconsidering the 2013 Final Rule, the Agencies will "stay faithful to Congress' intent, which is [that] [regulated] institutions, particularly the largest ones, should not have big proprietary trading businesses."[13]

Taken together, these statements strongly support the view that the purposes of the covered fund provisions of Section 13 are to: (1) restrict the ability of banking entities to engage in short-term proprietary trading or other high-risk activities indirectly through fund structures, (2) prohibit banking entities from guaranteeing, assuming, or otherwise insuring the obligations or performance of (i.e., "bailing out") any funds that they sponsor, organize and offer, advise or invest in and (3) limit conflicts of interest between banking entities and their customers, while at the same time continuing to permit banking

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[10] FINANCIAL STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS, p. 6 (Jan. 18, 2011) (emphasis added), https://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf.

[11] 156 CONG. REC. S5904 (daily ed. July 15, 2010).

[12] Federal Reserve Vice Chairman for Supervision Randal K. Quarles, *The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule* (Mar. 5, 2018), https://www.federalreserve.gov/newsevents/speech/quarles20180305a.htm.

[13] *Monetary Policy and the State of the Economy: Hearing Before the House Financial Services Committee* (July 18, 2018) (testimony of Federal Reserve Chairman Jerome H. Powell).

entities to make safe and sound investments indirectly through fund structures, which are in the public interest.

The Agencies' statutory authority to further tailor the definition of covered fund—and their public duty to do so—was recently highlighted by seven members of the Senate Banking Committee, including its Chairman Mike Crapo, and by three members of the House Financial Services Committee, including its Chairman Jeb Hensarling. The Agencies were encouraged "to use the discretion granted them by Congress in Section 619 [of Dodd-Frank] to revise the definition of 'covered fund' or include additional exclusions to address the current definition's overly-broad application."[14] In particular, the Agencies were directed to address the overly broad application of the 2013 Final Rule "to venture capital, other long-term investments and loan creation."[15] They reasoned that "[a]s a general matter, any activity permissible for a banking entity to do directly, especially those that provide stable capital and encourage economic growth, should be permissible through a fund structure as well" and noted that "[a]s Chairman Powell recently stated, these permissible activities do not threaten safety and soundness and themselves are subject to a comprehensive regulatory framework that imposes various requirements and limitations to address inherent risks."[16]

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[14] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("[T]he current construct of the Volcker Rule's covered funds definition unduly impedes banks' and their affiliates' abilities to perform their traditional functions through fund structures. Accordingly, pursuant to the discretion Congress granted to [the Agencies] in Section 619, the final amended Volcker Rule should provide greater regulatory relief and offer additional exclusions under the definition of a 'covered fund' . . . .").

[15] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("[T]he final amended Volcker Rule should provide greater regulatory relief and offer additional exclusions under the definition of a 'covered fund' for venture capital and other entities engaged in lending and long-term investing that promote growth and capital formation.").

[16] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("There is no good reason for the Volcker Rule to deny banks and their affiliates the ability to accomplish through fund structures—particularly those that provide stable capital and encourage economic growth—what they can do directly.

We agree with these members of Congress that imperative for the Agencies in re-evaluating the covered fund provisions of the 2013 Final Rule is to "address the current definition's overly-broad application."[17] In the following sections of this Annex B, we propose modifications to certain existing exclusions, and the creation of four new exclusions to accomplish this goal. As described in more detail below, our recommendations are consistent with the purposes of the covered fund provisions of Section 13 and are therefore well within the Agencies' statutory authority to further tailor the definition of "covered fund."

As Federal Reserve Chairman Powell recently testified before [the House Financial Services Committee], 'these activities are not ones generally that threaten safety and soundness.'").

[17] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001.

Annex C to SIFMA Supplemental Comment Letter:

Excerpt from 2018 Comment Letter Explaining Why Tailoring Authority is Not Constrained by the Ordinary Meaning of the Term "Private Equity Fund"[1]

[1] This Annex reproduces the relevant portion of the text of section I.B.3.d of Annex B of our 2018 Comment Letter.

We also believe that the proposed exclusion for qualifying long-term investment funds is consistent with the text of the covered funds portion of Section 13. In particular, we do not believe that the statutory authority of the Agencies is constrained by the ordinary meaning of the term private equity fund, if any such ordinary meaning exists, or by the definition of private equity fund in the SEC's Form PF.

The tailoring clause in subsection (h)(2) of Section 13 gives the Agencies broad authority to modify the statutory definition of the terms "hedge fund" and "private equity fund" in any way they choose, provided that they do so by joint rulemaking and their modification is consistent with the purposes of Section 13. The tailoring clause does not state that their tailoring authority is limited by the ordinary meaning of the term private equity fund or by the definition of private equity fund in the SEC's Form PF. Indeed, any argument based on the ordinary meaning of the term private equity fund is unpersuasive for at least five reasons.

First, Congress provided a single, explicit definition for the term "hedge fund and private equity fund" that obliterated the distinction between hedge funds and private equity funds, and relied on the definition of "investment company" instead of the ordinary meaning of the terms "hedge fund" or "private equity fund." The Supreme Court has repeatedly held, including in a *unanimous* decision just last term, that "[w]hen a statute includes an explicit definition, we must follow that definition, even if it varies from a term's ordinary meaning."[2] In *Digital Realty Trust v. Somers*, Justice Ruth Bader Ginsburg, writing for a unanimous Court, observed that the SEC had defined the term "whistleblower" more broadly than the underlying statute, based on the ordinary meaning of the word. The Court held that the statute's "unambiguous whistleblower definition . . . precludes the [SEC] from more expansively interpreting that term" based on any alleged ordinary meaning.[3] Since Congress provided an explicit definition for "private equity fund" in Section 13 that did not rely on the ordinary meaning of that term, the Agencies

[2] Digital Realty Tr., Inc. v. Somers, 138 S. Ct. 767, 776 (2018) (internal quotation marks omitted); *id.* at 783 (Thomas, J., concurring) (concurring in the opinion of the Court "only to the extent it relies on the text" of the Dodd-Frank Act). *See also*, *e.g.*, Burgess v. U.S., 553 U.S. 124, 129 (2008) ("'Statutory definitions control the meaning of statutory words . . . in the usual case.'"); Stenberg v. Carhart, 530 U.S. 914, 942 (2000) ("When a statute includes an explicit definition, we must follow that definition, even if it varies from that term's ordinary meaning.").

[3] Digital Realty Tr., 138 S. Ct. at 782. The Court did not "accord deference to the contrary view advanced by the SEC" in its rule, holding that "'Congress has directly spoken to the precise question at issue.'" *Id.* (quoting Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837, 842 (1984)).

are only constrained by the explicit definition of that term in Section 13, and not by its ordinary meaning, whatever that may be.

Second, Congress included the tailoring clause in the statutory definition of the term "hedge fund and private equity fund." As noted in the Preamble to the 2013 Final Rule, the tailoring clause authorizes the Agencies to modify the statutory definition of the term "private equity fund" by modifying the default definition or by modifying any existing exclusion or excluding any additional entities, provided that such modifications are consistent with the purposes of Section 13. The Agencies relied on the tailoring provision to create thirteen exclusions from the default definition of "covered fund" in the 2013 Final Rule. If the Agencies could use the tailoring power to do that, there is no reason why they cannot use it to create a new exclusion for qualifying long-term investment funds, provided that it is consistent with the purposes of Section 13, regardless of whether it is consistent with the ordinary meaning of the term private equity fund.

Third, it is illogical to treat direct and indirect investments differently or to ascribe an illogical intention to Congress, except to the extent required by the language or purposes of Section 13. As noted above, banking entities are expressly permitted to make direct, long-term investments in the equity securities of both financial and nonfinancial companies and are not prohibited or restricted from making such direct, long-term investments by Section 13. A long-term investment that is safe and sound and otherwise in the public interest when made directly does not become unsafe and unsound or contrary to the public interest solely because it is made indirectly through a fund vehicle, as long as the fund does not engage in short-term proprietary trading or other high-risk activity prohibited by Section 13, the banking entity is prohibited from bailing out any fund that it sponsors, advises or invests in, and the banking entity otherwise manages its investment in the fund consistent with safety and soundness standards substantially identical to those that would apply to direct investments by banking entity.

Fourth, construing Section 13 to prohibit all long-term investments made indirectly through a fund structure based solely on the use of the term "private equity fund" in the statute is inconsistent with the legislative history. In a colloquy between Senator Barbara Boxer and Senator Dodd, who sponsored the bill that became the Dodd-Frank Act, Senator Dodd stated that the covered fund provisions of Section 13 were not intended to prohibit or restrict investments in venture capital funds, if they are safe and sound and otherwise in the public interest.[4] Similarly, in a recent hearing of the House Financial Services Committee, several members of that committee expressed the view that Section 13 was not intended to prohibit or restrict investments in venture capital

[4] 156 CONG. REC. S5904 (daily ed. Jul. 15, 2010).

funds.[5] Since venture capital funds typically make long-term investments, this legislative history provides strong support for the view that the mere use of the term "private equity fund" does not justify a ban or restriction on all long-term investments made indirectly through a fund structure, but only those that are not consistent with the sort of safety and soundness standards that would apply to direct, long-term investments by banking entities.

Fifth, there is no universally agreed upon ordinary meaning of the term "private equity fund." Among other sources, we reviewed the instructions to the SEC's Form PF, but it did not provide a specific definition of the term based on its ordinary meaning. Instead, the instructions to Form PF provide specific definitions for the terms hedge fund, liquidity fund, real estate fund, securitized asset fund and venture capital fund, and simply define private equity fund as any private fund that is not one of these other funds.

Nor do we believe that the definition of private equity fund in the SEC's Form PF constrains the statutory authority of the Agencies to add the proposed, new exclusion for qualifying long-term investment funds. Form PF was adopted in 2011 after Section 13 was enacted. Form PF had a completely different purpose from the purposes of Section 13. Form PF is designed to gather data about a broad range of private funds—hedge funds, liquidity funds, real estate funds, securitized asset funds, venture capital funds and private equity funds—to facilitate the SEC's oversight of fund managers and to inform the Financial Stability Oversight Council as it considers any systemic risk posed by the activities of private funds. If the definition of private equity fund in Form PF is too broad, the consequence is that some information that should have been allocated to a different type of fund will be allocated to the private equity fund category. In contrast, if the definition of private equity fund in the instructions of Form PF were used to constrain the statutory authority of the Agencies to tailor the definition of covered fund, it would fundamentally alter the scope of the Section 13 covered fund provisions in a manner that was not intended.

Even though the tailoring power is not constrained by any alleged ordinary meaning of private equity fund, if any, or how the term is defined in Form PF, for the reasons set forth above, our proposed exclusion is limited to long-term investment funds that satisfy all of the conditions to be a qualifying long-term investment fund. Thus, private funds that engage in any short-term proprietary trading or high-risk activity would still fall within the definition of covered fund. Even private funds that engage solely in making long-term investments would continue to fall within the definition of covered fund, unless they satisfy all of the conditions of a qualifying long-term investment fund.

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[5] *Monetary Policy and the State of the Economy: Hearing Before the House Financial Services Committee* (July 18, 2018) (questions from Rep. Frank Lucas, Rep. Randy Hultgren, Rep. Ted Budd).

Those conditions include that any banking entity that sponsors, organizes and offers, advises or invests in the fund does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the fund. In the case of funds managed or controlled by the banking entity, the conditions also include that the fund conducts its activities consistent with safety and soundness standards that are substantially similar to those that would apply to any such banking entity if it engaged in the long-term investment fund's activities directly. In the case of non-controlling investments in a long-term investment fund managed and controlled by a third party, the conditions include that the banking entity's investment in, and relationship with, the fund must be in compliance with the safety and soundness standards that otherwise apply to non-controlling equity investments by the banking entity.

Finally, we do not believe that our proposed, new exclusion for qualifying long-term investment funds is inconsistent with the provisions in Section 13 establishing an extended conformance period for illiquid funds.[6] Citing to the statute's provisions regarding illiquid funds, the Agencies in the Proposal state that Section 13 "contemplates that the covered fund definition would include funds that make longer-term investments."[7] We agree that some funds that make longer-term investments are appropriately treated as covered funds under Section 13. The language in Section 13 regarding illiquid funds, however, does not delineate which vehicles that make long-term investments should be covered funds and which may be excluded by the Agencies pursuant to their tailoring authority. Instead, those provisions merely recognize that illiquid funds may require longer conformance periods to come into full conformance with Section 13 and any implementing regulations. Our proposed exclusion applies only to certain, qualifying long-term investment vehicles that can satisfy the four conditions set forth above and therefore would not exclude all vehicles that hold long-term investments, whether liquid or illiquid, and is consistent with the text and purpose of Section 13, including the text that provides for a longer conformance period for illiquid funds.

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[6] 12 U.S.C. §§ 1851(c)(3), (h)(7).

[7] 83 Fed. Reg. at 33479 (Question 169).