ARNOLD & PORTER LLP

David F. Freeman
David.Freeman@aporter.com

+1 202.942.5745
+1 202.942.5999 Fax

555 Twelfth Street, NW
Washington, DC 20004-1206

February 13, 2012

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

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve
System 10th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Robert E. Feldman
Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20551

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Rules "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-2011-0014; RIN: 1557-AD44; Federal Reserve: 12 C.F.R. Part 248, Docket No. R-1432, RIN: 7100 AD 82; FDIC: 12 C.F.R. Part 351, RIN: 3064-AD85; SEC: 17 C.F.R. Part 255 Release No. 34-65545; File No. S-7-41-11 RIN: 3235-AL07; CFTC; 17 C.F.R. Part 75 RIN: 3038-AC[·]

Ladies and Gentlemen:

We appreciate the opportunity to submit a comment letter on behalf of our client, The Bessemer Group, Incorporated ("Bessemer"), in response to the request for 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, and Securities and Exchange Commission to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or the "Act") regarding implementation of the "Volcker Rule" restrictions on proprietary trading by banking entities and certain relationships between banking entities and hedge funds and private equity funds.[1] We also submit this comment in response to the related rulemaking proposal of the CFTC to implement the Volcker Rule.[2] The Volcker Rule is codified as Section 13 of the Bank Holding Company Act ("BHC Act"), 12 U.S.C. § 1851.

Bessemer is a bank holding company that is registered as such with the Board of Governors of the Federal Reserve System pursuant to the Bank Holding Company Act of 1956 as amended, with its principal place of business in Woodbridge, New Jersey. Bessemer has two subsidiary banks, Bessemer Trust Company, N.A. (a national bank located in New York, New York) and Bessemer Trust Company (a New Jersey state-chartered bank located in Woodbridge, New Jersey) whose deposit accounts are insured by the FDIC, several subsidiary trust companies, a registered investment adviser, and a registered securities broker-dealer. Since the founding of Bessemer Trust Company by Henry Phipps in 1907, Bessemer's subsidiaries have provided trust, investment management and other fiduciary services as well as custody and other administrative services, to families, individuals and institutions. Bessemer's subsidiaries in the aggregate currently have management or supervision over approximately $63 billion in client assets. Bessemer remains owned by the Phipps family to this day.

Our comments are focused on two areas in the implementation of Section 619 of the Dodd-Frank Act: (1) private investment "funds of funds" advised and administered by banking entities to facilitate prudent diversification of a relatively small portion of their clients' investment portfolios into alternative asset classes and investment managers that are not otherwise available to the clients; and (2) pension and employee benefit and investment programs maintained by banking entities for their own officers, directors and employees.

Attached Appendix A contains our responses to certain of the questions that were included in the proposing release which accompanied the proposed rule.

As discussed more fully below, our comments are:

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[1] 76 Fed. Reg. 68846 (2011).

[2] 77 Fed. Reg. __ (2012).

- The statute and section .10 of the proposed rule do not prohibit a banking entity from "organizing and offering" covered funds, nor do they limit a banking entity only to "organizing and offering" fiduciary funds. In order to conform to the statute and to sections .10 and .12 of the proposed rule, the introductory provision of section .11 of the rule should be revised to read as follows: "**§__.11 Permitted sponsorship and bearing expenses of a covered fund.** Section _.10(a) prohibits a covered banking entity from sponsoring or bearing the expenses of a covered fund unless:..."

- Officers and employees of a banking entity who provide fiduciary services to clients that involve allocation of client assets into covered funds should be permitted to invest in covered funds in order to align their interests with the fiduciary clients.

- A personal trust in which an officer, director or employee of a banking entity is a beneficiary should be permitted to invest in a fiduciary fund maintained by a bank within the exemption for fiduciary funds contained in subsection 619(d)(1)(G) of the Act and Section .11 of the proposed rule on same basis as any other fiduciary account of the banking entity.

- The carve-out permitting investment in covered funds by pension and employee benefit plans should not be limited to "qualified plans". Non-qualified plans, whether domestic or foreign, and other employee investment and compensation programs, should also be permitted to invest in covered funds.

- Do not add "commodity pool operator" status to the list of relationships that are deemed to be sponsorship. Simply by adding commodity pools to the list of "covered funds," sponsorship of commodity pools is already included in the list of prohibited activities.

- Registered investment companies, business development companies, employee's securities companies, and traditional client trusts, that are also "commodity pools" should not be treated as "covered funds".

- A banking entity may invest a trust in a fiduciary capacity in a covered fund without regard to whether the trust has a limited term.

- Extend time period to conform prior investments to the second 3% aggregate investment limit.

- Provide additional time to develop and implement compliance programs.

Importance of Covered Funds to Prudent Diversification of Fiduciary Accounts

A prudent fiduciary is required to diversify client portfolios. The diversification concept is embodied in the "Prudent Investor Rule," the Third Restatement of Trusts, and Modern Portfolio theory, which are all an elaboration upon the old maxim "don't put all your eggs in one basket." The basic concept is that an investor can reduce the level of risk at the same level of investment return, or increase the level of investment return at the same level of risk, by spreading the investment portfolio across a range of investments that do not go up and down in value at the same time.

Spreading an investment portfolio across a broad mix of publicly-traded stocks and bonds representing many issuers, industries, business sizes, growth stages, and geographic regions, is a good start, but does not result in full diversification. Securities markets as a whole tend to move in unison. To be fully diversified, it is necessary to allocate a portion of the investment portfolio to alternative asset classes and investment managers with returns that are less correlated to the rise and fall of the securities markets as a whole. These alternative asset classes include such things as venture capital, hedge funds, private equity, real estate, and commodities. Though they comprise a relatively small portion of an investment portfolio, inclusion of these alternative investments plays an important role in reducing the overall volatility of the client's investment portfolio-- the year on year swings in value up and down-- thereby reducing the overall risk in the client's portfolio.

Generally speaking, the best of these alternative assets and investment managers are available to investors only through investment partnerships and limited liability companies that rely on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act for an exemption from registration under that Act. This is due to technical reasons that include the relatively small size of many of the investment pools, the requirements of the tax laws and the Investment Company Act, the illiquidity or use of leverage in the underlying investments, and the fact that these generally are not appropriate investments for retail investors.

Because these alternative investment partnerships and limited liability companies rely on Sections 3(c)(1) (which limits investment to not more than 100 beneficial owners) and

3(c)(7) (which limits investment to qualified purchasers), those sections, as well as the private placement exemption in Regulation D (17 C.F.R. § 230.501, which has long been interpreted to require a substantial preexisting relationship between the issuer or its placement agent and the investors), the Securities Exchange Act of 1934 (which requires registration of companies with 500 or more shareholders) and partnership tax laws (which include a safe harbor from being re-characterized and taxed as a public corporation for partnerships with 100 or fewer partners), the total number of direct investors that an alternative asset fund or its manager can accept is very limited.[3] Because the total number of direct investors is limited, the alternative fund manager normally will only accept investors with whom it has a preexisting relationship and who are willing to commit a very large dollar amount to the investment. Because the objective for the investor of investing in the alternative asset class is portfolio diversification, committing a large amount to a single alternative investment only makes sense if that investor has an extraordinarily large investment portfolio.

For a fiduciary such as Bessemer, there is the additional requirement of fairness in allocating investment opportunities among its clients and the need to make alternative investments available to each of its clients for whom the investment is appropriate. When a particular alternative investment fund would be appropriate for a hundred Bessemer clients, but only in a small amount for any one client, and the alternative fund manager is willing only to allow use of one investor "slot" for Bessemer's clients and only for a large investment amount, there is only one structural solution that allows Bessemer to make the investment available to its clients-- a private investment fund of funds.

A private investment fund-of-funds is a partnership or limited liability company that accepts investments from many investors, pools that money, and invests it in many different underlying private investment funds. This allows each investor in the private fund-of-funds to allocate a portion of the investor's portfolio into alternative investments without allocating a large part of the investor's portfolio to any one underlying alternative fund or manager or to alternative assets in the aggregate.

Creating a fund-of-funds to invest client assets into a portfolio of alternative asset funds managed by third-party investment managers also involves fewer risks to the firm, and

[3] In addition, private fund managers generally have a limited capacity to handle investor relations, administrative issues and communications with a larger number of separate investors, which further limits their willingness to accept a larger number of investors or investments in smaller amounts.

requires fewer resources to establish and operate, than attempting to create and advise a family of stand-alone private funds to invest directly in the relevant assets. In addition, the fund-of-funds structure provides clients with indirect access to investment with best-in-class alternative asset managers, and greater diversification than would be available through a private fund that invests directly in the underlying class of assets with the underlying investments selected by the firm's own portfolio managers.

Private investment funds-of-funds typically conform to SEC Staff interpretations of the "look through" provisions of Section 3(c)(1) and 3(c)(7) of the Investment Company Act, so that each of the investors in the fund-of-funds is not deemed to be a direct investor in each underlying private fund for purposes of determining each underlying fund's eligibility for the Section 3(c)(1) or 3(c)(7) exemption. Generally, this means that the fund-of-funds will own less than 10% of the voting interests any one underlying private fund, will spread its investments among at least three different underlying funds and not invest more than 40% of its committed capital in any one underlying private fund, and all investors in the fund-of-funds share pro-rata in the profits and losses of all of the various underlying private funds. Private funds-of-funds normally are far more diversified than SEC Staff interpretations require, spreading their investments in smaller pieces among a larger number of underlying private investment funds.

Over the past 15 years, Bessemer Trust Company, N.A. has served as investment advisor, administrator and custodian to a number of different private investment funds-of-funds in which its clients have been investors. These private investment funds-of-funds have invested in a variety of different alternative investment classes, including hedge funds, venture capital, private equity, and real estate. Bessemer makes such funds-of-funds available to its clients to facilitate diversification of client portfolios as a prudent investment manager, by allocating client investments among a broad range of investment classes. The private funds-of-funds have been established as limited liability companies ("LLCs") under Delaware law.

These LLCs are established to facilitate client investments in the asset classes and third-party investment managers represented by the underlying private investment funds (each underlying fund is a "Portfolio Fund").

Client-investors in the LLCs are "accredited investors" that are also "qualified purchasers" under the federal securities laws. Investors are provided private placement memoranda describing the LLC and the risks involved, which includes the federal banking agencies' "non-deposit investment products" disclosure, states that LLC losses are borne by investors not the bank, and that the bank does not guarantee the obligations of the LLC.

The LLCs do not use the word "Bessemer" in their names, do not share officers with Bessemer, and do not borrow from, lend to, buy assets from or sell assets to Bessemer. Bessemer does not guarantee the obligations of the LLCs or extend credit to the LLCs, extend credit to investors in order to finance an investment in the LLCs, or extend credit against the collateral of an interest in the LLCs.

Each LLC is a partnership for tax purposes but has no general partner or managing member. Instead, the LLC is governed by a board of managers elected by the investors/members of the LLC. At least sixty percent of the members of the board of managers are independent of Bessemer. The investor/members of the LLC may also remove and replace the bank as investment advisor and remove and replace the members of the board of managers.

The LLCs generally are passive, non-controlling investors in the Portfolio Funds. The LLCs generally do not employ leverage or incur debt, with the exception of short-term bridge financing by third-party lenders of cash to pay capital calls made on the LLC by Portfolio Funds during the brief period prior to the investors in the LLC fulfilling capital calls made on the investors by the LLC.

Bessemer has in the past invested as principal in the LLCs through its holding company, with the investment limited to less than a 5% equity interest, and typically is a smaller investment. Some or substantially all of the investment is held through or on behalf of non-qualified employee compensation programs or employees securities companies established for Bessemer personnel. Bessemer has invested a limited amount on its own behalf or on behalf of its qualified personnel into funds-of-funds that it advises to fulfill investor expectations that the interests of Bessemer and its staff are aligned with the clients' interests, and as a means of attracting and retaining qualified personnel to serve Bessemer's clients. Pending clarification of the final requirements of the rules implementing the Volcker Rule, Bessemer has deferred making further similar investments.

An LLC advised by Bessemer Trust Company, N.A. is treated as an "affiliate" of that bank and its sister banks for purposes of Sections 23A and 23B of the Federal Reserve Act and Regulation W. The affiliate transaction restrictions of those laws are designed to protect the bank and its trust clients by restricting investment in, loans or other credit extensions by the bank to, guarantees, asset purchases by the bank from, and other transactions by the bank with, the affiliate LLC.

In sum, the LLCs are established to facilitate prudent diversification of client investment portfolios by providing a means to access asset classes and third-party asset managers not otherwise available, and not as a means for Bessemer to invest as principal nor as a 'product' to be pushed on clients.

Investment by Officers, Directors and Employees in Funds-of-Funds Aligns their Interests with the Fiduciary Clients and Helps Attract and Retain Qualified Personnel

Bessemer invests as principal or in a fiduciary capacity in covered funds in connection with or on behalf of its own employees' pension and benefit plans, as well as in connection with investment opportunities made available to employees. This includes both employee pension and benefit plans that are subject to ERISA (qualified plans) such as defined benefit plans and defined contribution plans, and those which are not, such as deferred compensation programs.

In addition, Bessemer is one of many banking entities that have established "employees securities companies" under Section 6(b) of the Investment Company Act to facilitate collective investments in covered funds by bank employees. Accredited investor employees of Bessemer may invest indirectly through the employees securities company controlled by Bessemer that is established pursuant to an SEC order issued under the Investment Company Act to facilitate investment by employees.

In some cases, Bessemer invests in certain of the Bessemer-advised funds-of-funds in order to hedge obligations to employees under non-qualified deferred compensation plans, or as a diversifying investment for non-qualified defined benefit plans.

Each of these investments and programs are normal compensation and benefit programs that are designed to attract and retain qualified professionals to work at the company.

Certain officers, directors or employees of Bessemer who are deemed to be "qualified purchasers" under SEC rules are permitted to invest directly in private investment "funds of funds" advised by Bessemer.

Some individuals who are directors, officers or employees of Bessemer also establish personal trust accounts or are beneficiaries of family trust accounts that invest in covered funds through funds-of-funds advised by Bessemer. These fiduciary investments are not related to the capacity of the individual as an officer, director or employee of Bessemer as such, but in the capacity of that individual or the trust as a fiduciary client of Bessemer.

Permitting officers, directors and employees to invest in covered funds serves three purposes. It aligns the interests of Bessemer personnel with those of the bank's clients, it allows for prudent diversification of the investment portfolio of the Bessemer director, officer or employee, and it allows Bessemer to attract and retain qualified personnel. For a banking entity that provides *bona fide* fiduciary services to clients, as contrasted to a fund manager that simply offers fund products to investors, the banking entity personnel whose interests should be aligned with the client are not limited to those who service the covered fund. Rather, all directors, officers and employees of the banking entity who provide services to the clients or oversee the servicing of clients, set policy and define the scope of the fiduciary program (for example, approving a policy decision to use funds-of-funds that invest in alternative asset classes to provide prudent diversification of client portfolios), establish recommended asset allocations for client accounts, or advise, manage or administer the client accounts or the covered funds, appropriately ought to have their interests aligned with the fiduciary clients a portion of whose accounts are allocated into the covered funds.

From the perspective of the client, the question is not simply whether the portfolio manager of the covered fund is invested in the covered fund. The client wants to know whether the portfolio manager of the client's trust account, his or her boss, the chief investment officer of the bank, the members of the trust committee of the board, and the other senior management and directors of the bank, are invested in the covered fund as well.

Statute Does Not Restrict "Organizing and Offering" Covered Funds

Banking organizations have long been permitted to organize, offer and provide a variety of services to investment funds.[4] The statutory text of the Volcker Rule does not

[4] *See* 76 Fed. Reg. at 68856.

purport to restrict a banking entity from organizing or offering a covered fund. By its terms, the statutory text restricts investing as principal in a private investment fund and sponsoring a covered fund. The term "sponsor" is defined clearly in the statute in a way that is not triggered by a banking entity organizing and offering a covered fund. The statutory prohibitions and restrictions are contained in Subsections (a) and (f) of the Volcker Rule, and do not mention organizing and offering a covered fund.

The only reference in the statutory text to "organizing and offering" is as part of the conditions to the exemptions in subsections 619(d)(1)(G) and (d)(4) of the Act that permit a banking entity to do what otherwise would be prohibited by the statute: sponsor and invest as principal in a covered fund. Subsection 619(d) of the Act does not purport to impose a prohibition on anything other than use of the exemptions it provides from otherwise prohibited sponsorship and investment as principal. The heading of subsection 619(d) of the Act is "Permitted Activities" and its introductory language provides that "[n]otwithstanding the restrictions under subsection (a) ... the following activities are permitted...." Subsections 619(d)(1)(A) through (J) of the Act set forth a set of exemptions to the prohibitions of Subsection 619(a) of the Act. Each of exemptions (A) through (J) has its own conditions to a banking entity being able to use the particular exemption in order to avoid a prohibition otherwise applicable under Subsection 619(a) of the Act, but none of the exemptions enumerated in subsections 619(d)(1)(A) through (J) purports to prohibit an activity that is not prohibited by Subsection 619(a) of the Act. Section .10 of the proposed rule, which implements Subsection 619(a) of the Act, similarly does not mention or purport to prohibit a banking entity from "organizing and offering" a covered fund.

Subsection 619(d)(1)(G) of the Dodd-Frank Act contains an exemption from the otherwise applicable subsection 619(a) prohibition against a banking entity sponsoring or making an investment in a covered fund as principal, for fiduciary funds that are organized and offered by the banking entity for investment by its fiduciary clients. Subsection 619(d)(1)(G) provides that a banking entity can rely on the 619(d)(1)(G) exemption "only if" the arrangement meets the conditions specified in subparagraphs 619(d)(1)(G)(i) through (viii). Subparagraph 619(d)(1)(G)(vii) is a condition that precludes any director or employee of the banking entity from having an ownership interest in the fiduciary fund operated under subsection 619(d)(1)(G) unless that director or employee "is directly engaged in providing investment advisory or other services to the [covered] fund...."

The proposing release in some places acknowledges that the Volcker Rule addresses the "organizing and offering" of covered funds only as part of exemptions.[5] Other portions of the proposing release are loosely worded in a way that could be read to suggest that the Volcker Rule prohibits a bank from "organizing and offering" a covered fund other than a fiduciary fund that meets the requirements of Subsection 619(d)(1)(G) of the Act and Section .11 of the proposed rule.[6]

Section .10(a) of the proposed rule (which implements subsection 619(a) of the Act) does not mention or purport to prohibit a banking entity from "organizing and offering" a covered fund. Instead, section .10(a) of the proposed rule, like subsection 619(a) of the Act, prohibits sponsorship of or investment in a covered fund unless an exemption applies. The term "sponsor" is defined in the statute to include serving as a general partner, managing member, or trustee of a covered fund (to which the proposed rule adds the role of serving as the "commodity pool operator to a covered fund) and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, but does not mention organizing or offering a fund as an indicia of "sponsorship."

The awkwardly worded text of Section .11 of the proposed rule, however, appears to transform the Act's subsection 619(d)(1)(G) exemption into a prohibition against "organizing and offering" a covered fund other than within the subsection 619(d)(1)(G) fiduciary fund exemption. Section .11 of the proposed rule bears the heading "Permitted organizing and offering of a covered fund" and states that:

> "Section _.10(a) [of the proposed rule] does not prohibit a covered banking entity from … organizing or offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of a covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, … only if:"

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[5] *See, e.g.*, 76 Fed. Reg. at 68848.

[6] *See, e.g.*, 76 Fed. Reg. at 68900-01.

Section .12 of the proposed rule, like subsection 619(d)(4) of the Act, establishes an exemption that permits *de minimis* investment by a banking entity as principal into a covered fund that is organized and offered by the banking entity or its subsidiary or affiliate. The exemption in section .12 of the proposed rule, like the exemption in subsection 619(d)(4) of the Act, does not purport to limit the *de minimis* investment authority to fiduciary funds that operate within the fiduciary fund exemption of section .11 of the proposed rule and subsection 619(d)(1)(G) of the Act.

Thus, a plain reading of both the statutory text, and the text of sections .10 and .12 of the proposed rule, confirm that a banking entity can organize and offer a covered fund outside of the "fiduciary fund" exemption, invest in that fund up to the limits of subsection 619(d)(4) of the Act and section .12 of the proposed rule, and permit its officers, directors and employees to invest in that fund without regard to whether they personally are involved in providing services to that fund. Conditions to the "fiduciary fund" exemption in Subsection 619(d)(1)(G), which allows sponsorship of private funds for a bank's fiduciary clients, should not be read as applicable to private investment funds advised, organized and offered, but not sponsored, by a banking entity.

The main practical effect of applying the conditions to the Section 619(d)(1)(G) "fiduciary fund" exemption to any covered fund organized and offered by a banking entity would be to limit the personnel of the banking entity who are permitted to invest directly or indirectly in the covered fund solely to persons who provide services to the covered fund (such as investment management, administrative, or private placement agent services). Other officers, directors and employees of the banking entity would not be permitted to invest, a result that would not serve the interests of the clients of the banking entity or further the public interest.

Assuming that the agencies continue to interpret "bona fide fiduciary services" to include investors with no other relationship to the banking entity who receive investment management services indirectly through an investment in the covered fund,[7] each of the other conditions to the subsection 619(d)(1)(G) of the Act and section .11 of the proposed rule, other than the restriction on investment by employees and directors of the banking entity, does not add significant restrictions as each is either a best practice or required in substance by other provisions of the Volcker Rule or other applicable laws. For example,

[7] 76 Fed. Reg. at 68901.

to advise the covered fund, the banking entity necessarily is engaged in the business of providing investment advisory and fiduciary services for which trust powers or investment adviser registration is required.[8] The use of the word "bank" or a shared name in the fund's name is strongly discouraged by prior guidance,[9] and use of a shared name is an indicia of prohibited "sponsorship" of a covered fund.[10] The restriction on guaranteeing the performance of the covered fund in subsection 619(d)(1)(G)(iii) and (iv) of the Act and Section .11(e) of the proposed rule is separately imposed by subsection 619(f) of the Act (and by Section 23A and 23B of the Federal Reserve Act if the bank or its subsidiaries are providing the guarantee).[11] The required disclosure language in subsection 619(d)(1(G)(viii) of the Act and section .11(h) of the proposed rule is a good practice and consistent with disclosures in the banking agencies' February 1994 "Interagency Statement on Non-deposit Investment Products" and other FINRA and SEC guidance.[12] The limit on investment as principal by the banking entity in the covered fund is already covered by subsections 619(a) and 619(d)(4) of the Act. The attribution to the banking entity for the 3% investment limit by subsection 619(d)(4) of employee and director shares that are financed or guaranteed by the banking entity ignores the fact that such guarantees and financing are prohibited by Section 619(f) of the statute.

The text of proposed Section .11 also reiterates the roles that make a banking entity a sponsor. Sponsorship is defined elsewhere and its forms do not need to be repeated within Section .11. In order to clarify section .11 of the rule and conform it to the statute and the other provisions of the proposed rule, we suggest that the final text of the introductory provision of section .11 of the rule be revised to read as follows:

"§__.11 Permitted sponsorship and bearing expenses of a covered fund.

[8] *See* 12 U.S.C. § 92a, 15 U.S.C. § 80b, 12 C.F.R. § 9, 17 C.F.R. § 275.203.

[9] SEC Division of Investment Management, Letter to Registrants (May 13, 1993); Memorandum to SEC Chairman Breeden from Division of Investment Management (May 6, 1993); FDIC, Federal Reserve, OCC, OTS, Interagency Statement on Non-Deposit Investment Products (Feb. 14, 1994).

[10] 12 U.S.C. § 1851(h)(5)(C).

[11] 12 U.S.C. §§ 371c, 371c-1, 12 C.F.R. § 223.

[12] *See* FINRA Rule 3160.

> Section _.10(a) prohibits a covered banking entity from sponsoring or bearing the expenses of a covered fund unless:..."

This edit to the rule would both clarify the meaning of the rule and conform its effect to the text of the statute as drafted.

Treatment Under Section .11 of Proposed Rule and Subsection 619(d)(1)(G) of Statute of Investments Held in a Fiduciary Capacity for Directors, Officers and Employees of Banking Entity

As discussed above, the release suggests in some places that the proposed rule imposes a prohibition of a banking entity organizing and offering a covered fund other than pursuant to the "fiduciary fund" exemption of Subsection (d)(1)(G) of the statute and Section .11 of the proposed rule. Section .11 of the proposed rule implements the Section 619(d)(1)(G) statutory exemption. The description of section .11 in the proposing release contains language suggesting that a bank employee or director is only permitted to invest in a covered fund if he or she "is directly engaged in providing services to the covered fund...."[13] A consequence of such a reading would be to limit the employees who are permitted to invest in a covered fund only to those employees who service the covered fund. Under the statutory text of the Volcker Rule, there is no restriction on employee investment in a covered fund that is advised, organized and offered, but not sponsored, by a banking entity.

If Section .11 of the proposed rule is read to prohibit a banking entity from organizing and offering a covered fund other than under the fiduciary fund exemption of Subsection (d)(1)(G) of the statute, the proposed rule would only permit officers, directors and employees of a banking entity to invest in covered funds "organized and offered" by the banking entity if the officer, director or employee is directly involved in servicing the covered fund. As discussed above, we believe the wording of Section .11 of the proposed rule should be modified to remove any suggestion that a banking entity is prohibited from organizing and offering a covered fund other than within the fiduciary fund exemption of subsection 619(d)(1)(G) of the statute and Section .11 of the rule. If,

[13] 76 Fed. Reg. at 68896.

however, the agencies determine not to make those changes to the text of the proposed rule, we suggest that the restriction in Section .11 of the rule be broadened to permit investment in a fiduciary fund by a broader group of bank directors, officers and employees, directly, or indirectly through employee benefit programs or trust and fiduciary accounts.

The rationale behind the provision allowing directors and employees to invest in a fiduciary fund within subsection 619(d)(1)(G) of the Act and section .11 of the proposed rule is to address investor's desires that the covered fund manager's interests be aligned with fund investors by having some "skin in the game."[14] In the context of trust and investment advisory relationships, however, the covered fund is used as a part of an asset allocation strategy to diversify the client's account.

Fiduciary clients often want to know if the personnel who are designing and implementing the asset allocation for the client's account, and the directors and senior personnel who oversee the investment strategies and operations of the bank, are invested in the same underlying assets. The fiduciary clients often are less interested in whether the fund manager has money in the fund than whether the client's own account manager, and those above him or her who are responsible for the decisions of the bank to make the fund available as part of the bank's overall fiduciary operations, has allocated his or her own assets in the same way and into the same general asset classes and funds as the client's fiduciary account is being allocated.

The employees want their own personal investment portfolios prudently invested through allocations into appropriate assets classes, including alternative asset classes represented by covered funds (hedge funds, venture capital and private equity funds, commodity pools, and real estate funds). If employee accounts held at the banking entity cannot invest in covered funds, they cannot be fully diversified, and have greater risk than is appropriate. The alternative of having employee accounts held outside the banking entity and allowing employees to "trade away" from the banking entity is not an attractive alternative. It is more expensive, it presents a compliance and oversight risk,[15] and it undermines the credibility of the employee in speaking with clients of the banking entity.

[14] 76 Fed. Reg. at 68902.

[15] *See* NASD Rules 3040, 3050.

This issue arises both in the context of investment programs related to the status of the person as an officer, director or employee of the banking entity, such as qualified or non-qualified pension and employee benefit plans and employees securities companies, as well as individual trusts and fiduciary relationships for which the officer, director or employee is a client, settlor or beneficiary unrelated to the person's role at the banking entity.

Investments in a covered fund made by a bank director, officer or employee in his or her personal capacity are not restricted by the statutory text of the Volcker Rule, other than in the context of a "fiduciary fund" sponsored by the banking entity that relies on the exemption provided by subsection 619(d)(1)(G) of the Act. Similarly, investments by a bank in a trust or other fiduciary capacity for a bank director, officer or employee are not restricted by the statutory text of the Volcker Rule, other than in the context of a "fiduciary fund" sponsored by the banking entity that relies on the exemption provided by subsection 619(d)(1)(G) of the statute. If the covered fund is not operated in reliance on the subsection 619(d)(1)(G) exemption from the otherwise applicable prohibitions against banking entity sponsorship of a covered fund or investment as principal in a covered fund, there is no statutory restriction on a bank director, officer or employee investing in the covered fund or the bank investing on that person's behalf as a trustee or fiduciary.

To the extent that the final rule continues to require the "fiduciary" exemption requirements of Section .11 of the rule and Subsection 619(d)(1)(4) of the Act to be followed for covered funds that are organized and offered, but not sponsored, by a banking entity, we respectfully request that officers, directors and employees be permitted to invest in the covered fund directly or indirectly through personal trusts and accounts without regard to whether the individual provides services to the covered fund.

Employee Benefit Programs

The release accompanying the proposed rule specifies that a "qualified plan" as defined in section 401 of the Internal Revenue Code would not be prohibited from investing in a covered fund.[16] Presumably, this permits investments in covered funds by

[16] 76 Fed. Reg. at 68896.

qualified pension and employee benefit plans for employees of the banking entity, which plans are deemed to be "controlled" by the banking entity and therefore are themselves "banking entities."[17] Qualified and non-qualified plans of other employers for which a banking entity serves as trustee, adviser, custodian or provides other services are normally not deemed to be "controlled" by or "affiliates" of the banking entity[18] and therefore are not themselves "banking entities." An investment by a banking entity as trustee, custodian, adviser, fiduciary or other agent on behalf of a third party qualified or non-qualified plan would be within the broader statutory exemption for customer transactions in subsection 619(d)(1)(D) of the Act.

The release also specifies that a bank may acquire an interest in a covered fund to hedge its obligations to an employee under a compensation program, if the employee is involved in providing services to the covered fund.[19] We understand this to be a reference to a common type of non-qualified deferred compensation plan with the deferred payment linked to the return on the covered fund.[20]

Left unaddressed by the release, however, are (i) non-qualified plans that cover directors and employees who do not provide services to a covered fund, and (ii) employees' securities companies and other employee compensation and benefit programs controlled by the banking entity, particularly if they include directors and employees who do not provide services to the covered fund.

The term "qualified plan" is defined in the Internal Revenue Code, and serves purposes unrelated to the safety and soundness of banks, maintaining the separation of banking and commerce, or anything related to the Volcker Rule. Linking the permissibility of investment in covered funds to whether the particular employee benefit program is a "qualified plan" under the Internal Revenue Code adds an arbitrary requirement to the implementing rule, that is unrelated to safety and soundness or other Volcker Rule

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[17] *See* BHC Act §2(g)(2)(C), 12 U.S.C. 1841(g)(2)(C).

[18] 12 U.S.C. §§ 1841(g)(2)(C), 1842(a), 1843(c)(4).

[19] 76 Fed. Reg. at 68908-09.

[20] *See* OCC Banking Bulletin 2000-23 (2000); OCC Interpretive Letter No. 897 (Oct. 23, 2000); OCC Interpretive Letter No. 878 (Dec. 22, 1999), Federal Reserve Board Staff Letter to Anthony J. Horan, Chemical Banking Corporation, (July 22, 1994).

considerations. Pension and employee benefit plans that are made available solely to employees outside the United States in conformity with local laws and pension requirements are not "qualified plans" under the Internal Revenue Code or ERISA. Yet they serve precisely the same purpose as U.S.-qualified plans.

Although fiduciary investments in securities by a bank or bank holding company for the benefit of someone else generally are not attributed to the bank holding company in determining whether the bank holding company "controls" the issuers of those securities for purposes of the Bank Holding Company Act,[21] fiduciary investments held on behalf of the shareholders or employees of the bank holding company as such are aggregated with principal holdings of the bank holding company and counted towards "control" threshold.[22] The investment limits in the Volcker Rule, however, are not about "control" of the private fund, but about restricting the risk to the banking entity of its investments as principal in private investment funds.

Where, as here, the concern is limiting investment exposure of a banking entity, the federal banking regulators have treated investments for employee pension, benefit and deferred compensation programs as permitted even where the investment would not be permitted for the banking entity to make otherwise.[23] Accordingly, the various categories of investments made in connection with employee benefit, compensation and investment programs, to the extent they are subject to the Volcker Rule in the first instance and not within some other exemption, should be permitted either as fiduciary investments not restricted by the Volcker Rule, as hedging investments permitted under Subsection 619(d)(1)(C), or by rule adopted under Subsection 619(d)(1)(J).

In the case of qualified plans, investments in private investment funds are made for the plan and its related trust, and not for the banking entity as principal, and therefore as with other fiduciary investments should not be subject to the Volcker's rule's prohibition on investing in hedge funds and private equity funds.

[21] *See, e.g.*, 12 U.S.C. § 1843(c)(4); 12 C.F.R. § 225.22(d)(3).

[22] 12 U.S.C. § 1841(g); 12 C.F.R. § 225.22(d)(3)(ii).

[23] *See* OCC Banking Bulletin 2000-23 (2000); OCC Interpretive Letter No. 897 (Oct. 23, 2000); OCC Interpretive Letter No. 878 (Dec. 22, 1999). *Accord*, Federal Reserve Board Staff Letter to Anthony J. Horan, Chemical Banking Corporation, (July 22, 1994)(permitting such investments by a bank holding company at time Regulation Y prohibited investment by bank holding company in proprietary investment companies).

In the case of certain non-qualified deferred compensation plans, while the investments are made by the banking entity as principal, they are to precisely hedge deferred compensation owed by the banking entity to employees.[24] Investments to hedge obligations under deferred compensation plans should be permitted under the Volcker Rule as a permitted hedge under Subsection 619(d)(1)(C) as "risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings."

Similarly, investment in hedge funds and private equity funds by an employees' securities company established and controlled by a banking entity with a small equity investment, but overwhelmingly owned by employee-investors, should not be prohibited under the Volcker Rule. Although such companies are nominally "subsidiaries" of the bank holding company due to control by the banking entity, in fact they are investing money invested by employees with the risks and potential profits going to those investor-employees, and the parent banking entity has only a very limited equity investment in the employees securities company and no loans or guarantees to the employees securities company, its employee-investors or counterparties. Employees securities companies operate within a special statutory exemption from the Investment Company Act and the terms of individual SEC orders implementing that exemption.[25] Permitting these programs to continue does not pose a risk to the banking entity or the banking system as a whole, or involve a transfer of a federal deposit insurance risk subsidy or liquidity subsidy to the employees securities company or to the employees. To the extent not within another exemption, such employees securities company investments in covered funds should be permitted by rule adopted under Subsection 619(d)(1)(J).

We suggest that the final rule exclude investments by banking entities in private investment funds made and held in connection with pension and employee benefit plans, deferred compensation plans,[26] and employees securities companies[27] maintained by banking

[24] *See* OCC Banking Bulletin 2000-23 (2000); OCC Interpretive Letter No. 897 (Oct. 23, 2000); OCC Interpretive Letter No. 878 (Dec. 22, 1999). *Accord*, Federal Reserve Board Staff Letter to Anthony J. Horan, Chemical Banking Corporation, (July 22, 1994)(permitting such investments by a bank holding company at time Regulation Y prohibited investment by bank holding company in proprietary investment companies).

[25] Investment Company Act §§ 2(a)(13), 6(b).

[26] *See* OCC Interpretive Letter No. 878 (Dec. 22, 1999).

entities for their own current and former officers, directors, and employees without regard to whether the individual provides services to the covered fund. These types of investments are made and held as part of normal compensation programs to attract and retain qualified personnel to work at the banking entity, and to align their interests with the fiduciary clients of the bank. These types of investments are not made by a banking entity for the purpose of profiting on the investment in the covered fund.

Whether viewed as a hedge for the banking entity's pension and employee benefit obligations, as fiduciary assets held for others, or as simply a compensation program that benefits the banking entity by allowing it to attract and retained qualified personnel and align their interests with the fiduciary clients of the bank, investments in private investment funds should be permitted in connection within each of these types of programs under the Volcker Rule.

To the extent that the final rule continues to require the "fiduciary" exemption requirements of Section .11 of the rule and Subsection 619(d)(1)(4) of the Act to be followed for covered funds that are organized and offered, but not sponsored, by a banking entity, we respectfully request that officers, directors and employees be permitted to invest in the covered fund (and the banking entity be permitted to make such investments) through qualified or non-qualified pension and employee benefit plans and employee securities companies of the general types discussed above without regard to whether the individual provides services to the covered fund.

Treatment of Commodity Pool Operators as "Sponsors"

The text of section 619 of the Act contains a clear definition of a "sponsor" to include serving as a general partner, managing member or trustee of a covered fund, selecting or controlling the selection of a majority of the directors, trustees or management of the covered fund, or sharing a name with the covered fund. The proposed rule would add the status of being a "commodity pool operator" ("CPO") to this set of relationships that define a "sponsor" of a covered fund. The purpose of the addition, apparently, is to fully effectuate the agencies' decision to add "commodity

Footnote continued from previous page
[27] *See* Investment Company Act §§ 2(a)(13), 6(b), 15 U.S.C. § 80a.

pools" to the list of "other similar funds" that are "covered funds" whose relationships with banking entities are subject to the restrictions of the Volcker Rule.

There is no need, however, to add the CPO relationship to the definition of "sponsor" in order to include commodity pools as "covered funds" or to prohibit sponsorship of commodity pools. Commodity pools are a regulatory construct, not a type of legal entity. Commodity pools are structured like other securities investment funds that rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act. Most are limited partnerships, limited liability companies or trusts, and have a general partner, managing member or one or more trustees. The statutory definition of "sponsor" will automatically pick up these same relationships in respect of a commodity pool, without the need to include the CPO construct to the Volcker Rule's definition of a "sponsor."

The Commodity Exchange Act and regulations of the CFTC contain definitions of "commodity pool operator" and a series of exemptions from the definitions and from regulation under the requirements applicable to CPOs.[28] CPO registration and regulation is the way in which the CFTC regulates the operation of the commodity pool through required disclosures to investors, a filing with the CFTC so the regulators know the fund exists and how to reach it, and additional requirements for publicly offered and retail commodity pools, rather than a means to define a relationship between the CPO and the commodity pool. The concept of CPO is essentially a hook used to impose indirectly through the fund's advisor and administrator a set of substantive regulatory requirements on the commodity pool that are analogous in a way to regulation of an investment company under the Investment Company Act.

The Volcker Rule does not prohibit a banking entity from serving as an investment adviser or administrator to covered funds. By adding CPO status to the list of what makes a banking entity a "sponsor" of a fund, the proposed rule would treat what amounts to a fund advisory and administrative relationship as a relationship that is prohibited by the Volcker Rule in the case of a fund that is a commodity pool. The effect of the addition of CPO status to the definition of "sponsor" would be to prohibit banking entities from being the CPO to a commodity pool with which the banking entity does not

[28] 17 C.F.R. §§ 4.5, 4.7, 4.13.

share a name, whose officers and directors it does not select, and for which commodity pool the banking entity is not the general partner, trustee, or managing member.

CPO registration and exemption requirements cover not only funds that trade in futures contracts, but also securities funds with very limited and indirect involvement with futures contracts. Hedge fund advisers commonly are required to make CPO filings (or file for an exemption as an exempt pool operator)[29] because technically the securities fund is within the definition of a commodity pool if it simply has authority to invest in futures contracts. If adopted in its current proposed form, this broadened Volcker Rule sponsorship prohibition would extend not only to a banking entity serving as CPO for a commodity pool that invests extensively in futures contracts and other regulated commodity interests, but also securities funds that invest (or are authorized to invest even if they never use the authority) to a limited degree in futures contracts, and private securities funds-of-funds that have passive, non-controlling investments in private investment funds managed by third parties that in turn invest (or are authorized to invest even if they never use the authority) to a limited degree in futures contracts.

As drafted, by treating CPO status as the equivalent of fund sponsorship, the rule would impinge on the ability of bank trust departments to fully diversify fiduciary accounts through investment of a portion of the fiduciary portfolio directly or indirectly through a fund-of-funds into investment funds that invest a portion of their assets in futures contracts.

To the extent that the agencies include the CPO relationship in the final rule's definition of sponsorship, we respectfully suggest that it be limited to serving as CPO for a commodity pool that does not rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act for an exemption from that Act.

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[29] The CFTC has recently repealed certain of these exemptions, which will have the effect of treating many advisers to securities investment funds as CPOs. *See* CFTC, *Final Rules: Commodity Pool Operators and Commodity Trading Advisors; Amendments to Compliance Obligations* (Feb. 2012); CFTC, Proposed Rule: *Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations*, 76 Fed Reg. 7976 (Feb 11, 2011); CFTC, Proposed Rules: *Amendments to Commodity Pool Operator and Commodity Trading Advisor Regulations Resulting from Dodd-Frank Act*, 76 Fed. Reg. 11701 (Mar. 3, 2011).

Treatment of Registered Investment Companies as Commodity Pools

The Proposed Rule would add "commodity pools" to the list of prohibited investment funds for which a banking entity is not permitted to act as a sponsor or invest in as a principal. Currently, many registered investment companies invest to a limited degree in futures contracts and operate within a long-standing exemption from treatment as "commodity pools."[30] Recently, however, the CFTC has significantly narrowed this exemption, which will cause many registered investment companies to fall within the definition of a "commodity pool" and require registration of the mutual fund's investment adviser as a "commodity pool operator."[31] Many mutual funds invest in derivatives to a limited degree, primarily for interest rate, currency and other hedging purposes. Other mutual funds invest in derivatives for investment diversification purposes or to track indices. Under the amended rule, many SEC-registered investment companies will be treated as "commodity pools" and thus as "covered funds" subject to the prohibitions of the Volcker Rule under the implementing rules as currently proposed.

Mutual funds and other registered investment companies are heavily regulated by the SEC under the Investment Company Act as well as the Securities Act of 1933 and Securities Exchange Act of 1934. The comprehensive SEC-administered program of regulation of registered investment companies includes, among other requirements and limits, independent governance requirements and conflicts of interest prohibitions, detailed disclosure and reporting obligations, tight restrictions on use of leverage, as well as concentration limits and diversification and liquidity requirements. The SEC regulates, among other things, the use of derivatives by registered investment companies.[32]

[30] 17 C.F.R. § 4.5.

[31] *See* CFTC, Final Rules: *Commodity Pool Operators and Commodity Trading Advisors; Amendments to Compliance Obligations* (Feb. 2012); CFTC Proposed Rules: *Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators* (Feb. 2012); CFTC, Proposed Rule: *Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations*, 76 Fed Reg. 7976 (Feb 11, 2011); CFTC, Proposed Rules: *Amendments to Commodity Pool Operator and Commodity Trading Advisor Regulations Resulting from Dodd-Frank Act*, 76 Fed. Reg. 11701 (Mar. 3, 2011).

[32] SEC, *Use of Derivatives by Investment Companies Under the Investment Company Act of 1940*, SEC Rel. IC-29776, 76 Fed. Reg. 55237 (Sept. 7, 2011).

In enacting the Volcker Rule, Congress intended to limit exposure of banking entities to the unregulated world of hedge funds, private equity funds, and other funds that are ***not*** regulated by the SEC under the Investment Company Act. This is evident from the definitions of the scope of the covered class of hedge funds and private equity funds in the statute by reference to the Section 3(c)(1) and 3(c)(7) private fund exclusions from the definition of "investment company" and from registration and regulation with the SEC pursuant to the Investment Company Act.

We respectfully request that, to the extent that the agencies choose to proceed with a final rule that adds "commodity pools" to the list of "covered funds" under the Volcker Rule, the agencies exclude commodity pools that are registered with and regulated by the SEC as investment companies or business development companies pursuant to the Investment Company Act or that are employees securities companies operating under the framework established for such companies under the Investment Company Act.

Section 2(b) of the BHC Act Was Not Intended to Turn Trusts into "Companies" Except Where the Trust Controls A Banking Entity

The proposing release acknowledges that banking entities are permitted to invest in a fiduciary capacity in covered funds by noting that "the proposed rule would not prohibit the acquisition or retention of an ownership interest (including a general partner or membership interest) in a covered fund: (i) By a banking entity in good faith in a fiduciary capacity, except where such ownership interest is held under a trust that constitutes a company as defined in section (2)(b) of the BHC Act…."[33] Section 2(b) of the BHC Act is codified at 12 U.S.C. § 1841(b) and provides in part that a trust is not a "company" if "by its terms it must terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust…." The effect of this reference in the release is to suggest that a banking entity is not permitted to invest the assets of a client trust in a covered fund unless the trust has a limited term of the type specified in section 2(b) of the BHC Act. "Dynasty trusts" or other client trusts that do not have the term limit set forth in Section 2(b) of the BHC Act would not be permitted to invest in covered funds.

[33] 76 Fed. Reg. at 68896.

The text of Section 619 of the Dodd-Frank Act, however, does not reference Section 2(b) of the BHC Act as a limit on the customer investment exemption in subsection 619(d)(1)(D) or the fiduciary fund exemption of subsection 619(d)(1)(G) of the Dodd-Frank Act.

Moreover, the Federal Reserve has long read Section 2(b) of the BHC Act, which excludes trusts from the definition of "company," to impose a term limit only on trusts that own banks. For example, in proposing amendments to Regulation Y in 1983, the Board stated that:

> Bank holding companies and their subsidiaries are permitted under section 4(c)(4) of the BHC Act to acquire and hold nonbanking securities and activities in a fiduciary capacity so long as they are not held for the benefit of the bank holding company, its subsidiaries, or its employees. Under the BHC Act, this provision does not permit a bank holding company subsidiary to acquire nonbank securities and activities as fiduciary for a trust that is a "company" (as defined in section 2(b) of the BHC Act). The legislative history of this provision suggests this limitation is intended to apply only where the trust is also a bank holding company. Thus, if the trust itself is not a bank holding company, the exemption is available to the bank holding company subsidiary that acts as fiduciary. (Of course, if the trust is a bank holding company, it is subject to the same limitations of this subpart with respect to its nonbank securities and activities that apply to any other bank holding company.)"[34]

Accordingly, consistent with the statutory text of the Volcker Rule, and with the Federal Reserve Board's long standing interpretation of Section 2(b) of the BHC Act, the adopting release and the final rules implementing the Volcker Rule should make clear that a banking entity is permitted to invest client trusts into covered funds, regardless of whether the trust has a term limit.

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[34] Federal Reserve, *Bank Holding Companies and Change in Bank Control; Proposed Revision of Regulation Y*, 48 Fed. Reg. 23520, 23529 (May 25, 1983).

Conforming Pre-Existing Investments to the Second 3% Test

The statutory text of the Volcker Rule contains several different exemptions from its prohibitions, each with its own subparagraph. These include the subsection 619(c) provision that gives banking entities a period of several years to bring existing investments and activities into conformity with the Volcker Rule, the subsection 619(d)(1)(G) provision permitting the investment in, and sponsorship of, "fiduciary funds," and the subsection 619(d)(4) provision permitting "seed money" investments.

The text of subsections 619(d)(1)(G) and 619(d)(4) of the Act expressly count investments made under either provision together towards the maximum investment that a banking entity may acquire and retain of not more than 3% of the interests in the covered fund (the "first 3% test") and not more than 3% of the capital of the banking entity (the "second 3% test"). However, the statutory text of the Volcker Rule does not aggregate investments held under other provisions of the Volcker Rule towards the first 3% test or the second 3% test. In particular, pre-existing investments held under authority of subsection 619(c) of the Act during the conformance periods specified in the statute are not aggregated with new investments made under subsections 619(d)(1)(G) and 619(d)(4) of the Act or counted towards either the first 3% test or the second 3% test.

In view of the plain language of the statute, we understand the second 3% cap in subsection 619(d)(4)(B)(ii)(II) of the Act and section .12 of the proposed rule on "the aggregate of all such interests of the banking entity in all such funds" made under the "seed money" exemption does not require the aggregation of pre-existing investments that are allowed to be held during a transition period under subsection 619(c) of the Act with new investments made under the subsection 619(d)(1)(G) and 619(d)(4) exemptions.[35] As has been the case with other restrictions on bank securities activities,[36] the separate subparagraphs of the Volcker Rule should be read as written to supply separate and

[35] Under this approach a banking entity would be permitted to conform pre-existing seed money investments by the end of the Section 619(c) conformance period to the percentage limits in Subsection 619(d)(4)(B), and after the expiration of the conformance period the pre-existing seed money investments would be included in the Subsection 619(d)(4)(B)(ii) aggregate.

[36] *See, e.g.*, Federal Reserve, SEC, *Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks*, 72 Fed. Reg. 56514, 56516 (Oct. 3, 2007) (adopting release for Regulation R, 12 C.F.R. § 218, 17 C.F.R. § 247, implementing the remaining "bank" exemptions from the definition of "broker" in section 3(a)(4) of the Securities Exchange Act of 1934).

independent exemptions that, to the extent available, a banking entity can choose to rely upon, but the election to rely on one exemption does not preclude the availability of a different exemption, if the conditions of the exemption are met.

The proposing release confirms that investments made or held under other provisions of the Volcker Rule are not aggregated with investments made under Subsections 619(d)(1)(G) and 619(d)(4) of the Act and section .12 of the proposed rule, for purposes of the investment limits of 619(d)(1)(G) and 619(d)(4) of the Act and section .12 of the proposed rule.[37] We respectfully suggest that the agencies maintain this separateness in the final version of the rule, and not aggregate investments in covered funds held under authority of other provisions of the Volcker Rule with investments made and held under Subsections 619(d)(1)(G) and 619(d)(4) of the Act and section .12 of the proposed rule or otherwise count them towards the "second 3%" cap which limits aggregate investments in all covered funds under authority of subsections 619(d)(1)(G) and 619(d)(4) of the Act.

Similarly, Section .12(d) of the proposed rule differentiates the treatment of investments in covered funds under Section .12 from investments made in covered funds under other provisions, and imposes a deduction from a banking entity's regulatory capital only in respect of the amount invested in covered funds pursuant to the authority of Section .12. The proposing release makes clear that the capital deduction does not apply to investments in covered funds held under authority of other provisions of the Volcker Rule.[38] Accordingly, the proposed rules do not impose a deduction from capital for pre-existing investments in covered funds held during the compliance period pursuant to subsection 619(c) of the Act and Subpart E of the proposed rule.[39]

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[37] 76 Fed. Reg. at 68904-05.

[38] 76 Fed. Reg. at 68905. *Accord*, Federal Reserve, *Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities*, 76 Fed. Reg. 8265, 8273 (Feb. 14, 2011).

[39] Other bank regulatory requirements, however, impose capital penalties on the existing investments in covered funds. Investments in hedge funds and private equity funds have long been subject to capital haircuts under the federal banking agencies' regulatory capital standards. A portion of the value of the investment is deducted from the aggregate consolidated Tier 1 capital of the banking entity before calculating compliance with capital requirements. 12 C.F.R. § 225, App. A Section II.B.2.b.5 (Deductions from Capital and Other Adjustments, Other subsidiaries and investments, Nonfinancial equity investments). In the case of private investment funds for which the banking entity or its subsidiary serves as general partner or managing member, the capital of the limited partners is not consolidated with the capital of the banking entity, but additional capital must be maintained by the banking entity based upon the amount of

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Consistent with this treatment, we respectfully request that the adopting release accompanying the final rule make clear that these and other interests in a covered fund held by a banking entity other than pursuant to subsections 619(d)(1)(G) and 619(d)(4) of the Act and section .12 of the rule, including hedging positions, investments held by a banking entity as part of a qualified or non-qualified plan, investments of an employees' security company controlled by a banking entity,[40] and prior investments held during the conformance period pursuant to subsection 619(c) of the Act, are not subject to or included within the "second" 3% aggregate limit on investments in covered funds made pursuant to subsections 619(d)(1)(G) and 619(d)(4) of the Act, and do not require a deduction from regulatory capital of the banking entity.

Additional Time for Compliance With the Second 3% Test

The proposing release cites Section 619(d)(4)(C) of the Act for the proposition that "[t]he statute provides the possibility of an extension only with respect to the per-fund limitation [capping investment by the banking entity at not more than 3% of a covered fund's capital], and not to the aggregate funds limitation"[41] of 3% of the banking entity's capital invested into all covered funds. However, with respect to pre-existing investments in covered funds, the Federal Reserve Board has separate authority pursuant to subsections 619(c)(2) and 619(c)(3) of the Act, and subpart E of the proposed rule, to extend the time period within which a banking entity must divest investments and conform its preexisting investments to the limits set forth in the statute, including compliance with the cap on investments to not more than 3% of the banking entity's capital invested into all covered funds. Moreover, the regulators have authority pursuant

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liabilities of the investment fund. *Dresdner Bank AG*, 84 Federal Reserve Bulletin 361 (1998). As a result, there is no need for the rules implementing the Volcker Rule to increase the capital haircuts applicable to covered funds during the transition period for pre-existing investments.

[40] As discussed more fully above, these investments related to employee plans and employees securities companies are not made or held by the banking entity for the purpose of seeking a profit on the investment for the banking entity, but instead are made and held as part of normal compensation programs to attract and retain qualified personnel to work at the banking entity, to align their interests with the fiduciary clients of the bank, and generally either to meet fiduciary obligations in managing employee or plan money or to hedge compensation obligations of the banking entity on its deferred compensation programs.

[41] 76 Fed. Reg. at 68906.

to subsection 619(d)(1)(J) to grant additional exemptions from the prohibitions of the Act.

In order to avoid "fire sales" of covered fund assets or of interests in covered funds, we respectfully request that the Federal Reserve Board exercise its authority under subsections 619(c)(2) and 619(c)(3) of the Act, and Subpart E of the proposed rule, to extend the time periods within which a banking entity must conform investments in covered funds to which the banking entity was committed prior to May 2010 to the second "aggregate" 3% test, to the latest extension date authorized under the extension powers of subsections 619(c)(2) and 619(c)(3) of the Act. Moreover, because that time period (through July 21, 2021) may prove insufficient in certain cases involving illiquid interests in covered funds that own long-term illiquid assets, we respectfully suggest that the agencies exercise their authority under subsection 619(d)(1)(J) to permit a longer time period for a banking entity to conform to the second 3% aggregate test.

Provide Additional Time to Develop and Implement Compliance Program

The compliance and internal control program requirements of the proposed rule are complex and will require a substantial effort by all banking entities to develop and implement. A number of points of uncertainty remain as to the requirements of the statute and the final requirements of the proposed rules to implement the statute and how they will be interpreted and applied. Because this is a new program to all banking entities as well as the regulators, and because the rulemaking process is running a few months behind the statutory schedule, it would be appropriate to defer full compliance with the compliance program requirements, and implement the requirements of sections .15 and .20 and Appendix C of the proposed rule in stages, with the first stage to be completed by December 31, 2012.

We suggest that the stages conform to a normal ordering of the steps to be taken in developing and implementing a complex compliance, reporting and control infrastructure effort. For example, designation of a compliance officer and line of reporting to the appropriate board committee and adoption of a very simple board policy on compliance with the Volcker Rule would be a first stage to be completed at a relatively early compliance date, creation of an inventory and position reporting program would be a later stage at an interim date, and full compliance with all provisions of Appendix C deferred to a later date.

A staged effort would permit the development by banking entities, systems providers, accounting, consulting and law firms, and trade associations, of appropriate informal guidance, systems and programs, and allow the banking agencies to issue informal guidance on best practices. This staged effort and deferred implementation of full compliance program requirements would result in a more consistent and higher quality set of compliance, control and infrastructure programs across the banking industry to achieve the objectives of the Volcker Rule.

Conclusion

In implementing the Volcker Rule, we urge the agencies to take into account the potential for unintended impact upon prudent fiduciary and investment practices of banking entities seeking to broadly diversify client investment portfolios, and also take into account the need of banking entities to attract and retain qualified personnel. The use of alternative asset classes, including hedge funds, real estate, private equity, venture capital and commodities are necessary elements to prudent diversification. As part of a well-structured portfolio, these asset classes do not increase client risk, they reduce it. Private funds-of-funds are the only practical way for a banking entity to make these diversification opportunities available to clients in a prudent manner. To attract and retain qualified personnel, and to align their interests with those of the clients, it is appropriate to permit all qualified personnel of a banking entity -- not merely those who directly service a particular fund -- to invest directly, or indirectly through trust accounts and qualified or non-qualified employee benefit plans and investment programs, into the same covered funds as are used for investment of client accounts.

We appreciate the opportunity to submit this comment on the proposed rules to implement Section 619 of the Dodd-Frank Act 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 (202) 942-5745.

Respectfully submitted,

David F. Freeman, Jr.

Appendix to Comments of The Bessemer Group, Incorporated
<u>On Proposed Rule to Implement the Volcker Rule</u>

Set forth below are comments of The Bessemer Group, Incorporated ("Bessemer") in response to certain of the questions posed in the interagency release, which are intended to supplement the attached comment letter dated February 13, 2012 submitted on behalf of Bessemer ("Comment Letter").

<u>Question 1.</u> Does the proposed effective date provide banking entities with sufficient time to prepare to comply with the prohibitions and restrictions on proprietary trading and covered fund activities and investments? If not, what other period of time is needed and why?

The proposed rule does not provide enough time to comply with the divestiture requirements for pre-existing investments in illiquid funds. An extension of at least ten years (to July 21, 2024) is appropriate to comply with the "second 3% test" in Subsection 619(d)(4)(B)(ii)(II) of the Volcker Rule, 12 U.S.C. 1851(d)(4)(B)(ii)(II), in respect of illiquid funds to which the banking entity was committed to invest prior to April 2010. These are investments as to which a banking entity may not have reasonable means to liquidate within a shorter time period. This extension would provide more time for banking entities to reduce investments in illiquid funds below 3% of the regulatory capital of the banking entity.

<u>Question 2.</u> Does the proposed effective date provide banking entities with sufficient time to implement the proposal's compliance program requirement? If not, what are the impediments to implementing specific elements of the compliance program and what would be a more effective time period for implementing each element and why?

No, the proposed effective date does not provide sufficient time to develop and implement an appropriate compliance program. An extension of time, and a phased-in time to comply with different required elements as suggested in Question 4 below, such that the first elements of the program be adopted by year end 2012, and additional elements added over subsequent periods, would be appropriate for meeting the requirement of the rule to adopt policies and procedures, recordkeeping, controls and compliance systems and related infrastructure (collectively "compliance program") in respect of "covered fund" investments and activities. Significant lead time is required to develop, adopt and implement the compliance program requirements applicable to covered funds under the new rules that will implement the Volcker Rule. The Volcker Rule specified that the rules were to be adopted in final form by October 21, 2011, but were not published in draft form until November 7, 2011 and will not be adopted in final form before the first quarter of 2012. Due to the complexity of the task and the delays in getting the rule adopted within the statutory timeframe, it would be appropriate to extend and phase in over time the timeframe within which the compliance program for covered funds activities must be implemented.

<u>Question 3.</u> Does the proposed effective date provide banking entities sufficient time to implement the proposal's reporting and recordkeeping requirements? If not, what are the impediments to implementing specific elements of the proposed reporting and recordkeeping requirements and what would be a more effective time period for implementing each element and why?

More time is appropriate to develop and implement reporting and recordkeeping systems. The statute required final rules to be adopted no later than October 21, 2011. The rules were not published in proposed form until November 2011 and the comment periods remains open through February 13, 2012. Final rules will presumably be adopted sometime after that.

The process for tracking, documenting and reporting positions and compliance with the new requirements is complex. As discussed above in response to Questions 1 and 4, we suggest a phase-in process for the compliance program requirements of the Volcker rule, with the recordkeeping and reporting requirements required to be in place not earlier than 2013.

Question 4. Should the Agencies use a gradual, phased in approach to implement the statute rather than having the implementing rules become effective at one time? If so, what prohibitions and restrictions should be implemented first? Please explain.

Yes, the agencies should use a gradual, phased in approach to implement the statute, rather than having the implementing rules become effective all at the same time. We suggest the following schedule for phased in implementation:

Prohibition on new proprietary trading and new investments in covered funds: July 21, 2012;

Requirement for board of directors to designate a Volcker Rule compliance officer and adopt simple board level policies for compliance with Volcker Rule: September 30, 2012;

Adoption of management-level compliance policies and procedures for Volcker Rule: December 31, 2012;

Implementation of recordkeeping requirements: January 1, 2013;

Implementation of reporting requirements: July 1, 2013; and

Mandatory divestiture of illiquid investments by banking entities in covered funds to which the banking entity was committed to invest prior to May 1, 2010: July 1, 2024.

Question 5. Is the proposed rule's definition of banking entity effective? What alternative definitions might be more effective in light of the language and purpose of the statute?

We suggest that qualified and non-qualified domestic and foreign pension and employee benefit plans, registered investment companies, business development companies, and employees' securities companies, be excluded from definition of "banking entity". These are entities that may be operated and controlled by a banking organization, but not as vehicles for proprietary investing. The purposes behind the Volcker Rule will not be furthered by restricting the investments of these entities, which are established to hold investments for clients or for employees. Prohibiting investments by these types of entities into covered funds will not enhance the safety and soundness of individual banks or of the banking system, but will instead harm the ability of banking organizations to attract and retain qualified personnel, and undermine the ability of banking organizations to service the investment needs of their clients.

<u>Question 6.</u> Are there any entities that should not be included within the definition of banking entity since their inclusion would not be consistent with the language or purpose of the statute or could otherwise produce unintended results? Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not?

Yes, registered investment companies should be excluded from the definition of "banking entity." As mentioned in response to Question 5 above, we suggest that qualified and non-qualified domestic and foreign pension and employee benefit plans, registered investment companies, business development companies, and employees' securities companies be excluded from definitions of "banking entity".

<u>Question 7.</u> Is the proposed rule's exclusion of a covered fund that is organized, offered and held by a banking entity from the definition of banking entity effective? Should the definition of banking entity be modified to exclude any covered fund? Why or why not?

We agree with the intent of this aspect of the proposed rule, but suggest it be broadened as noted in response to Questions 5 and 6 above. Qualified and non-qualified domestic and foreign pension and employee benefit plans, registered investment companies, business development companies, and employees' securities companies, in most cases do not rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act for an exemption from regulation under that Act, but instead either rely on other exemptions or exclusions from the definition of an "investment company" under the Act, or are registered under the Act. Accordingly, they are not "covered funds" and not within the scope of the proposed carve-out. We suggest that these types of entities also be excluded from the definition of "banking entity."

<u>Question 8.</u> Banking entities commonly structure their registered investment company relationships and investments such that the registered investment company is not considered an affiliate or subsidiary of the banking entity. Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not? Are there circumstances in which such companies should be treated as banking entities subject to section 13 of the BHC Act? How many such companies would be covered by the proposed definition?

In some cases, registered funds and other entities that are regulated under the Investment Company Act may be deemed to be "controlled" by a bank or bank holding company (for example, closed-end funds). Registered investment companies, business development companies and employees' securities companies that have filed with the SEC pursuant to the Investment Company Act should be excluded from the definition of "banking entity" unless such an entity is itself registered as a "bank holding company" pursuant to section 3 of the Bank Holding Company Act of 1956. The purpose of such funds is to invest, reinvest and trade in securities, subject to the requirements of the Investment Company Act. These funds are not insured by the FDIC and do not benefit from the federal safety net or special federally-guaranteed borrowing programs. The relationship between banks and these funds is subject to the requirements of Sections 23A and 23B of the Federal Reserve Act and Regulation W. Designating these types of funds as "banking entities" for purposes of the Volcker Rule would preclude these funds from engaging in the investment activities intended for them by Congress in the Investment Company Act, and would not enhance the safety or soundness of the banking system, but would instead undermine the safety and soundness of the banking system by detracting from the ability of banking entities to attract and retain qualified personnel, align their interests with the interests of clients, and provide appropriate investments for clients.

> **<u>Question 199.</u> Is the manner in which the proposed rule permits the use of disclosure in certain cases to address and mitigate conflicts of interest appropriate? Why or why not? Should additional or alternative requirements be placed on the use of disclosure to address and mitigate conflicts? If so, what additional and alternative requirements, and why? Is the level of detail and specificity required by the proposed rule with respect to disclosure appropriate? If not, what alternative level of detail and specificity would be more appropriate?**

Disclosure and consent is the appropriate means to address conflicts of interest in dealings with institutional and high net worth counterparties and customers. We also suggest that, for covered funds with a board that includes independent members, approval of a majority of a committee of independent board members be added to the rule as a means to address and resolve conflicts of interest.

> **<u>Question 200.</u> Should the proposed rule require written disclosure to a client, customer, or counterparty regarding a material conflict of interest? If so, please explain why written disclosure should be required. Are there certain circumstances where written disclosure should be required, but others where oral disclosure should be sufficient? For example, should oral disclosure be permitted for transactions in certain fast-moving markets or transactions with sophisticated clients, customers, or counterparties? If oral disclosure is permitted under certain circumstances, should subsequent written disclosure be required? Please explain.**

We agree with this general approach as a means to addressing conflicts of interest. We note, however, that this is an area already covered by federal securities laws. In crafting disclosure requirements, we respectfully suggest that thought be given to not adding unnecessarily to what are already detailed and lengthy disclosures provided to investors in private investment funds, which are used to address disclosure requirements under the federal securities laws.

> **<u>Question 201.</u> Should the proposed rule provide further detail regarding the types of conflicts of interest that cannot be addressed and mitigated through disclosure? If so, what type of additional detail would be helpful, and why? Should the proposed rule enumerate an exhaustive or non-exhaustive list of conflicts that cannot be addressed and mitigated through disclosure? If so, what conflicts should that list include, and why?**

Disclosure and informed consent by a sophisticated investor ought to be sufficient to serve as a waiver to most types of conflict of interest. As noted above in response to Question 199, we also suggest that, for covered funds with a board that includes independent members, approval of a majority of a committee of independent board members be added as a means to address and resolve conflicts of interest.

<u>Question 202.</u> **Should the proposed rule provide further detail regarding the frequency at which disclosure must be made? Should general disclosure be permitted for certain types of transactions, classes of transactions, or activities? For example, should a banking entity be permitted to make a one-time, written disclosure to a client, customer, or counterparty prior to engaging in a certain type of transaction or activity? Should general disclosure be permitted for certain types of clients, customers, or counterparties (e.g., highly sophisticated parties)? Please explain why specific disclosure (i.e., prior to each transaction, class of transaction, or activity) would not be necessary under the identified circumstances. Are there any clients, customers, or counterparties that should be able to waive a material conflict of interest under certain circumstances? If so, under what circumstances would a waiver approach be appropriate and consistent with the statute? Please explain.**

In the context of private funds, a one-time initial disclosure in the private placement memorandum and/or related governing documents of the subscription agreements ought to be sufficient to address most types of conflicts that can be anticipated. As noted above in response to Question 199, we also suggest that, for covered funds with a board that includes independent members, approval of a majority of a committee of independent board members be added as a means to address and resolve conflicts of interest. This can be used to address individual conflict issues that come up in particular transactions, as well as certain types of conflicts that may not have been anticipated. Individual transaction-by-transaction disclosure to, and consent of, all clients of every conflict would interfere with the ability of the banking entity to manage the covered fund and the accounts of clients that are invested in the covered fund. They cannot all be reached promptly, will not all respond promptly, and generally do not want to be bothered with this level of detail. At most, after-the-fact, annual summary of conflict transactions is what clients will tolerate, after they have given informed consent at the outset of the investment in a covered fund to the existence of certain categories of conflicts in the operation of that covered fund. If the focus is, as it should be, on what level and frequency of contact the clients want on these types of issues, the appropriate response is they do not want contact on routine conflict transactions of the sorts to which they have already provided informed consent.

<u>Question 206.</u> **Are there circumstances in which disclosure might be impracticable or ineffective? If so, what circumstances, and why?**

Transaction-by-transaction disclosure and consent frequently is impractical given the number of client accounts, their advance general consent to particular categories of conflict transaction, and the general desire of most clients not to be bothered on a frequent basis with administrative details in the operation of their accounts. Many cannot be reached promptly, and a significant proportion simply will not respond to affirmative response procedures. In addition, some clients require blind trusts or similar management arrangements that are designed for various reasons (for example, compliance with insider trading laws and policies) to restrict their access to information on the specifics of their own accounts. Advance general notice of and consent to categories of conflict transaction is sufficient. As noted above in response to Questions 199 and 202, we suggest that, for covered funds with a board that includes independent members, approval of a majority of a committee of independent board members be added as a means to address and resolve conflicts of interest.

<u>Question 208.</u> Should the proposed rule mandate the use of other means of managing potential conflicts of interest? If so, what specific means should be considered? How effective are any such methods as currently used? Can such methods be circumvented? If so, in what ways?

As noted above in response to Questions 199, 202 and 207, we suggest that, for covered funds with a board that includes independent members, approval of a majority of a committee of independent board members be added as a means to address and resolve conflicts of interest.

<u>Question 209.</u> What burdens or costs might be associated with the disclosure-related or information barrier-related requirements contained in the proposed definition of material conflict of interest? How might these burdens or costs be eliminated or reduced in a manner consistent with the purpose and language of section 13 of the BHC Act?

See responses above to Questions 199-208.

<u>Question 210.</u> Are there specific transactions, classes of transactions or activities that should be managed through consent? If so, what transactions or activities, and why? What form of consent should be required? What level of detail should any such consent include? Should consent only apply to certain conflicts and not others? If so, which conflicts? Are there circumstances in which obtaining consent might be impracticable or ineffective? Should consent be limited to certain types of clients, customers, or counterparties? If so, which clients, customers, or counterparties? Are there certain types of clients, customers, or counterparties for whom consent would never be sufficient? Are there additional steps that a banking entity that seeks to manage conflicts of interest through the use of consent should be required to take? Please specify such steps.

See responses above to Questions 199-208.

<u>Question 212.</u> Should the proposed rule provide for specific types of procedures that would be more effective in managing and mitigating conflicts of interest than others? Do banking entities currently use certain procedures that effectively manage and mitigate material conflicts of interest? If so, please describe such procedures and explain why such procedures are effective. Is the proposed rule consistent with such procedures? Why or why not? What are the costs and benefits of modifying your current procedures in response to the proposed rule?

As noted above in response to Questions 199, 202 and 207, we suggest that, for covered funds with a board that includes independent members, approval of a majority of a committee of independent board members be added to the rule as a means to address and resolve conflicts of interest.

<u>Question 215.</u> Is the proposed rule's approach to applying section 13 of the BHC Act's restrictions related to covered fund activities and investments to those instances where a banking entity acts "as principal or beneficial owner" effective? If not, why? What alternative approach might be more effective in light of the language and purpose of the statute?

As discussed in pages 14-20 of the attached Comment Letter, investments made in connection with qualified and non-qualified employee benefit and pension plans and employees' securities companies of a banking entity should not be subject to the restrictions of the Volcker Rule that apply to proprietary investments by a banking entity in covered funds. These investments are not made as proprietary investments on which the banking entity seeks to profit, but instead in order to attract and retain qualified personnel, align their interests with the interests of clients, and provide appropriate investment diversification for employees who participate in these programs. While some of these investments are nominally made by the banking entity as principal, the increase and decrease in value of these investments pass through to the participating employees. As a practical matter, these investments represent deferred compensation of employees, or amounts invested by employees in the covered funds.

<u>Question 216.</u> Does the proposed rule effectively address the circumstances under which an investment by a director or employee of a banking entity in a covered fund would be attributed to a banking entity? If not, why? What alternative might be more effective?

The proposed rule attributes ownership of individuals to the banking entity when a banking entity finances the investment by the individual in a covered fund by a director or employee and/or guarantees that investment against decline in value. We believe that approach is appropriate, and also that the corollary is appropriate: an investment in a covered fund by a director or employee is not attributed to the banking entity where the director or employee invests in a covered fund without financing being provided or guaranteed by the banking entity and without the investment principal or return being guaranteed to the investor by the banking entity.

<u>Question 217.</u> Does the proposed rule's definition of "covered fund" effectively implement the statute? What alternative definitions might be more effective in light of the language and purpose of the statute?

Inclusion of "commodity pools" should be limited in such a way so as not to include investment companies that are registered under the Investment Company Act, or business development companies or employees' securities companies under that Act, that may be "commodity pools" or exempted pools for technical reasons. See pages 20-24 of Comment Letter.

<u>Question 218.</u> Is specific inclusion of commodity pools within the definition of "covered fund" effective and consistent with the language and purpose of the statute? Why or why not?

The inclusion of commodity pools within the definition of "covered funds" would be appropriate if registered investment companies, business development companies and employees' securities companies that have registered or filed for exemptive orders with the SEC pursuant to the Investment Company Act, as well as customer trusts, bank common trust funds and collective investment funds, are specifically excluded in the final rule from those "commodities pools" brought within the scope of "covered funds" by such designation. These types of entities are investment funds that invest primarily in securities and are subject to SEC requirements imposed under the Investment Company Act and do not rely on the Section 3(c)(1) or 3(c)(7) exemptions from the definition of "investment company" in the Investment Company Act, but in some contexts currently, or under rule changes the CFTC may make in the future, be deemed to be "commodity pools" as a result of relatively small direct or indirect investments in derivatives or in funds that invest in derivatives (or simply the authority to make such investments regardless of whether actually made). Including registered investment companies, business development companies and employees' securities companies that have filed with the SEC pursuant to the Investment Company Act, or customer trusts or bank common trust funds or collective investment funds within the definition of "covered funds" solely as a result of small direct or indirect positions in derivatives would not further the purposes of Congress in the Volcker Rule, foster investor protection or promote safe and sound bank operations. See pages 20-24 of Comment Letter.

Question 219. The proposed definition of "sponsor" focuses on "the ability to control the decision-making and operational functions of the fund." In the securitization context, is this an appropriate manner to determine the identity of the sponsor? If not, what factors should be used to determine the identity of the sponsor in the securitization context for purposes of the proposed rule and why? Is the definition of "sponsor" set forth in the SEC's Regulation AB an appropriate party to treat as sponsor for purposes of the proposed rule? Is additional guidance necessary with respect to how the proposed definition of "sponsor" should be applied to a securitization transaction?

The definition of "sponsor" in the statute is very specific. Had Congress intended it to be a functional definition based on "the ability to control the decision-making and operational functions of the fund" Congress would have written the definition to say that. The statute and proposed implementing rules are overly complex as it is. We respectfully suggest that they not be made more so by broadening out the definition of "sponsor" with functional tests.

Question 221. Should the definition of "covered fund" focus on the characteristics of an entity rather than whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act? If so, what characteristics should be considered and why? Would a definition focusing on an entity's characteristics rather than its form be consistent with the language and purpose of the statute?

Sections 3(c)(1) and 3(c)(7) of the Investment Company Act do not speak to form, rather to the number and type of investors or beneficial owners in the fund, regardless of the organizational form of the fund. The statute and proposed implementing rules are overly complex as it is. We respectfully suggest that they not be made more so by broadening out the definition of "covered fund" with functional tests.

Question 224. Is specific inclusion of certain non-U.S. entities as a "covered fund" under § __.10(b)(1)(iii) of the proposed rule necessary, or would such entities already be considered to be a "covered fund" under § __.10(b)(1)(i) of the proposed rule? If so, why? Does the proposed rule's language on non-U.S. entities correctly describe those non-U.S. entities, if any, that should be included in the definition of "covered fund"? Why or why not? What alternative language would be more effective? Should we

define non-U.S. funds by reference to the following structural characteristics: whether they are limited in the number or type of investors; whether they operate without regard to statutory or regulatory requirements relating to the types of instruments in which they may invest or the degree of leverage they may incur? Why or why not?

Non-U.S. entities would not be "covered funds" without the extension by rule to cover them. *See, e.g.*, *The France Growth Fund, Inc*, SEC Staff Letter avail. July 15, 2003; *Goodwin, Proctor & Hoar* SEC Staff Letter avail. Feb. 28, 1997; *Touche, Remnant & Co.* SEC Staff Letter avail. Aug. 27, 1984 (foreign investment companies can conduct private placements with U.S. persons and rely on Section 3(c)(1) or 3(c)(7) of the Investment Company Act in respect of the U.S. portion of their investor base, without being subject to the requirements of Section 3(c)(1) or 3(c)(7) for their non-U.S. investor base and without being deemed to be Section 3(c)(1) or 3(c)(7) funds). Foreign publicly-offered or publicly-traded investment companies should be excluded from the extended definition of "covered funds," as should foreign qualified and non-qualified pension and employee benefit plans and their related funds and trusts. These types of foreign entities are not analogous to the domestic private investment funds at which the Volcker Rule is directed, but instead are similar to U.S. registered investment companies and employee benefit plans that are excluded from the statutory definition of "covered funds."

<u>Question 225.</u> Are there any entities that are captured by the proposed rule's definition of "covered fund," the inclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?

We suggest that qualified and non-qualified domestic and foreign pension and employee benefit plans, registered investment companies, business development companies, and employees' securities companies be excluded from the definition of "covered funds." Foreign pension and employee benefit plans generally are not qualified plans under the Internal Revenue Code or ERISA, may not be within the exemptions for domestic pension and employee benefit plans under the Investment Company Act, and may be caught up within the definition of "covered funds" in the proposed rule. Under the proposed rule, only qualified plans are exempt. Including non-U.S. and other non-qualified pension and employee benefit plans and employees' securities companies would not further the purposes of Congress in the Volcker Rule, foster investor protection or promote safe and sound bank operations.

The inclusion of commodity pools within the definition of "covered funds" may potentially bring some registered investment companies, business development companies and employees' securities companies that have filed with the SEC pursuant to the Investment Company Act within the definition of "covered funds." These investment funds are subject to SEC requirements imposed under the Investment Company Act and do not rely on the Section 3(c)(1) or 3(c)(7) exemptions from the definition of "investment company" in the Investment Company Act. Similarly, individual client trusts, as well as bank common trust funds and collective investment funds may be captured by amended commodity pool rules. Including registered investment companies, business development companies and employees' securities companies that have filed with the SEC pursuant to the Investment Company Act, or individual client trusts or bank common trust funds or collective investment funds, within the definition of "covered funds" solely as a result of small direct or indirect positions in derivatives would not further the purposes of Congress in the Volcker Rule, foster investor protection or promote safe and sound bank operations.

See pages 16-20 and 23-24 of Comment Letter.

<u>Question 233.</u> Should entities that rely on a separate exclusion from the definition of investment company other than sections 3(c)(1) or 3(c)(7) of the Investment Company Act be included in the definition of "covered fund"? Why or why not?

No. Banks, bank holding companies, common trust funds, collective investment funds, pension and employee benefit plans, insurance companies, broker-dealers, swap dealers, finance companies and various other financial services entities rely on other exclusions in Section 3(c) of the Investment Company Act. To reach these entities as "covered funds" is not within the intent of the Volcker Rule and would be unnecessary, inappropriate and profoundly disruptive.

<u>Question 234.</u> Do the proposed rule's definitions of "ownership interest" and "carried interest" effectively implement the statute? What alternative definitions might be more appropriate in light of the language and purpose of the statute? Are there other types of instruments that should be included or excluded from the definition of "ownership interest"? Does the proposed definition of ownership interest capture most interests that are typically viewed as ownership interests? Is the proposed rule's exemption of carried interest from the definition of ownership interest with respect to a covered fund appropriate? Does the exemption adequately address existing compensation arrangements and the way in which a banking entity becomes entitled to carried interest? Is it consistent with the current tax treatment of these arrangements?

In respect of the second to last question within Question 234, as discussed at pages 16-20 of the Comment Letter, the proposed rule should be modified to permit investment in covered funds by banking entities to hedge obligations under non-qualified benefit plans, without a limitation to interests of individuals who provide services to the covered fund.

<u>Question 242.</u> Do the proposed rule's definitions of "sponsor" and "trustee" effectively implement the statute?

As discussed at pages 20-24 of the Comment Letter, service as a "commodity pool operator" should not be included within the final rule's definition of a "sponsor" of a covered fund.

Is the exclusion of "directed trustee" from the definition of "trustee" appropriate?

Yes, the proposed exclusion of "directed trustee" from the definition of "trustee" is appropriate. It may be appropriate to clarify that traditional client trust accounts for which a bank serves as discretionary trustee are not by implication "covered funds" that are "sponsored" by the bank.

<u>Question 244.</u> Is the proposed rule's approach to implementing the exemption for organizing and offering a covered fund effective? If not, what alternative approach would be more effective and why?

No. The statute does not prohibit a banking entity from organizing and offering a covered fund. Instead, the statute creates an exemption that permits a banking entity to invest in and/or sponsor a covered funds if certain conditions are met, one of which is that the covered fund is organized and offered by the banking entity. The description of the proposed rule in the proposing release appears in places to suggest that a banking entity is not permitted or organize and offer a covered funds, other than pursuant to the fiduciary fund exemption of Section 619(d)(1)(G) of the statute. The impact of this misapplication of the statute would be to inappropriately restrict which directors and employees of a banking entity are permitted to invest in a covered fund that is organized and offered, but not sponsored, by the banking entity. We respectfully suggest that the introductory language of section .11 of the proposed rule be revised to read as follows:

> "§__.11 **Permitted sponsorship and bearing expenses of a covered fund.** Section _.10(a) prohibits a covered banking entity from sponsoring or bearing the expenses of a covered fund unless:..."

In the alternative, we suggest that a broader range of directors, officers and employees of a banking entity be permitted to invest in a fiduciary fund under 619(d)(G) and .11 of the proposed rule or a covered fund organized and offered by the banking entity under Section 619(d)(4) of the statute and Section .12 of the proposed rule, for the reasons set forth at pages 3 and 8-20 of our attached Comment Letter.

<u>Question 245.</u> Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

See pages 3 and 8-20 of the attached Comment Letter.

<u>Question 246.</u> Is the proposed rule's approach to implementing the scope of <u>bona fide</u> trust, fiduciary, investment advisory and commodity trading advisory services consistent with the statute? If not, what alternative approach would be more effective? Should the scope of such services be broader or, in the alternative, more limited? Are there specific services which should be included but which are not currently under the proposed rule?

No, the proposed rule inappropriately converts an exemption that permits a banking entity to sponsor a fiduciary fund into a prohibition on organizing and offering covered funds other than within the fiduciary fund exemption. See pages 9-14 of the attached Comment Letter.

<u>Question 247.</u> Does the proposed rule effectively implement the "customers of such services" requirement? If not, what alternative approach would be more effective and why? Is the proposed rule's approach consistent with the statute? Why or why not? How do banking entities currently sell or provide interests in covered funds? Do banking entities rely on a concept of "customer" by reference to other laws or regulations, and if so, what laws or regulations?

See pages 4-9 of the Comment Letter.

<u>Question 248.</u> Does the proposed rule effectively and clearly recognize the manner in which banking entities provide trust, fiduciary, investment advisory, or commodity trading advisory services to customers? If not, how should the proposed rule be modified to be more effective or clearer?

See pages 4-9, and 24 of the Comment Letter.

<u>Question 249.</u> Should the Agencies consider adopting a definition of "customer of such services" for purposes of implementing the exemption related to organizing and offering a covered fund? If so, what criteria should be included in such definition? For example, should the customer requirement specify that the relationship be pre-existing? Should the Agencies consider adopting an existing definition related to "customer" and if so, what definitions (for instance, the SEC's "pre-existing, substantive relationship" concept applicable to private offerings under its Regulation D) would provide for effective implementation of the customer requirement in section 13(d)(1)(G) of the BHC Act? If so, why and how? How should the customer requirement be applied in the context of non-U.S. covered funds? Is there an equivalent concept used for such non-U.S. covered fund offerings?

Although we are not adverse to including a substantial pre-existing relationship requirement, we note that such a requirement applies already under SEC Regulation D, and applies to the offering of covered funds. Inclusion of such a requirement in the final rules would be duplicative of that existing SEC requirement and potentially would diverge over time and conflict with the SEC requirement in some details. We note, moreover, that Section .11 of the proposed rule inappropriately converts an exemption that permits a banking entity to sponsor a fiduciary fund into a prohibition on organizing and offering covered funds other than within the fiduciary fund exemption. See pages 9-14 of the attached Comment Letter.

<u>Question 250.</u> Should the Agencies distinguish between direct and indirect customer relationships for purposes of implementing section 13(d)(1)(G) of the BHC Act? Should the rule differentiate between a customer relationship established by a customer as opposed to a banking entity? If so, why?

We are not quite sure what this question is suggesting should be done in practical terms, but it may make more complex and burdensome a set of requirements that are already more burdensome that is necessary or appropriate. We therefore suggest that the rule not be made more restrictive in the definition of customer relationships than in the proposed rule.

<u>Question 253.</u> Does the proposed rule effectively implement the prohibition on a covered fund sharing the same name or variation of the same name with a banking entity? If not, what alternative approach would be more effective and why? Should the prohibition on a covered fund sharing the same name be limited to specific types of banking entities (e.g., insured depository institutions and bank holding companies) or only to the banking entity that organizes and offers the fund, and if so why?

Yes, the proposed rule effectively implements the prohibition on a covered fund sharing the same name or variation of the same name with a banking entity.

<u>Question 254.</u> Does the proposed rule effectively implement the limitation on director or employee investments in a covered fund organized and offered by a banking entity? If not, what alternative approach would be more effective and why? Should the agencies provide additional guidance on what "other services" should be included for purposes of satisfying § __.11(g)? Why or why not?

No, the proposed rule expands a condition to an exemption that permits a banking entity to engage, in the context of a fund operated for fiduciary clients, in otherwise impermissible sponsoring activity, and transforms it into a prohibition on a banking entity organizing and offering a fund. The statute does not prohibit banking entities from organizing and offering covered funds that are not sponsored by the banking entity, nor does it prohibit employees, officers and directors from investing in covered funds that are not sponsored by the banking entity.

Moreover, for a banking entity that operates in a true fiduciary function, the fiduciary clients are interested in alignment of the interests of the client's account manager, and the team that develops the investment strategy and a recommended asset allocation for the client's fiduciary account, with the client's interests through the investment by the banking entities officers, employees and directors in the same categories of investments and funds. The recommendation and decision to invest the client's fiduciary account into the asset class and into the particular covered funds is at least as important as the investment decisions made at the fund level. The client is not simply interested in the alignment of the interests of the employees who service the covered fund with the client's interest, the client also wants to know that the persons (and their direct and indirect supervisors) who are recommending the asset class and particular covered fund also have "skin in the game." To the extent that the agencies impose the conditions to the "fiduciary fund" exemption on all covered funds organized and offered by a banking entity, we urge that the categories of directors and employees who are permitted to invest directly or indirectly in the covered fund not be limited to those individuals who service the covered fund.

See pages 3, 8-20 of the attached Comment Letter for a discussion of this issue.

<u>Question 255.</u> Are the disclosure requirements related to organizing and offering a covered fund appropriate? If not, what alternative disclosure requirement(s) should the proposed rule include? Should the Agencies consider adoption of a model disclosure form related to this requirement? Does the timing of the proposed disclosure requirement adequately address disclosure to secondary market purchasers?

The disclosure requirements in the proposed rule are appropriate, and many of them have been standard practice for quite some time. Tying these disclosures, however, to the exemption for "fiduciary funds" from the prohibition on sponsoring covered funds, and labeling it as an exemption from a prohibition against organizing and offering covered funds, misses the point that the statute does not prohibit banking entities from organizing and offering covered funds.

See pages 3, 8-20 of the attached Comment Letter for a discussion of this issue.

<u>Question 256.</u> Is the proposed rule's approach to implementing the exemption that allows a banking entity to make or retain a permitted investment in a covered fund effective? If not, what alternative approach would be more effective and why?

Further refinements of the proposed rule would be appropriate in this regard. See pages 14-20 (employee benefit plans and employees securities companies) 24-25 (client dynasty trusts) and 25-29 (pre-May 2010 investments in covered funds) of the Comment Letter.

<u>Question 257.</u> Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

We suggest that the final rule permit directors and employees to invest directly or indirectly in the covered fund regardless of whether they are involved in servicing the covered fund. See pages 3, 8-9, 12, and 14-20 of the attached Comment Letter.

<u>Question 260.</u> Does the proposed rule effectively implement the requirement that a banking entity comply with the limitations on the aggregate of all investments in all covered funds? If not, what alternative approach would be more effective and why?

See pages 27-29 of the Comment Letter.

<u>Question 261.</u> Is the proposed rule's approach to calculating a banking entity's investment in a covered fund effective? Should the per-fund calculation be based on committed capital, rather than invested capital? Why or why not? Is the timing of the calculation of a banking entity's ownership interest in a single covered fund appropriate? If not, why not, and what alternative approach would be more effective and why? For example, should the per-fund calculation be required on a less-frequent basis (e.g., monthly) for funds that compute their value and allow purchases and redemptions on a daily basis (e.g., daily)? Why or why not?

Invested capital is the correct measure, as set forth in the proposed rule. Generally speaking, an investor in a private equity, venture capital or real estate private fund (or in a private fund-of-funds that invests in those types of private funds) commits in the subscription agreement to invest money over time, up to a maximum commitment amount, when it is called in by the private fund.[1] Normally this type of private fund has a finite term. Typically there is a cut-off date in the fund documents after which the private fund cannot call in capital, or cannot commit to new portfolio investments. More often than not, while substantially all of the committed capital will be called in over time, the entire amount subscribed to by an investor is never called in at once, cash from liquidations of portfolio investments by the fund are returned to investors as dispositions occur, and as a result, the full amount is not actually invested in the private fund at any given time. Moreover, as portfolio investments are sold by the private fund, the proceeds are distributed to investors. In Bessemer's experience, on average the net contributed capital actually invested in these types of funds

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[1] Hedge funds typically do not work in the same way. Instead, an investor invests as of dates (most often quarterly or semi-annually) when the fund opens for additional investments, but does not commit to make future investments.

at any point in time typically does not exceed roughly 60-65 percent of the amount committed by investors in the subscription agreements. If a private fund of this sort runs into significant investment difficulties before the committed capital is fully called in, normally it will slowly wind down, rather than calling in good money after bad. As a result, the amount committed in the subscription agreement normally is far in excess of what actually is invested or at risk at a given time.

Question 262. Is the proposed rule's approach to parallel investments effective? Why or why not? Should this provision require a contractual obligation and/or knowing participation? Why or why not? How else could the proposed rule define parallel investments? What characteristics would more closely achieve the scope and intended purposes of section 13 of the BHC Act?

No, the approach of attributing to the banking entity the investments of each company in which the banking entity owns a 5% or more interest is overly complicated and places on banking entities a burden of monitoring and conforming the investment activities of companies that are not in fact controlled by the banking entity and in respect of which the banking entity is not in a position to monitor and control its investments. The statute and rule are complicated enough as is, and this type of attribution provision compounds the compliance burden. To the extent that this approach is continued in the final rule, we respectfully suggest that attribution only be applied in respect of investments of companies of which the banking entity owns as principal 25% or more of the equity.

<u>Question 263.</u> Is the proposed rule's treatment of investments in a covered fund by employees and directors of a banking entity effective? If not, what alternative approach would be more effective and why?

No, the proposed rule expands a condition to an exemption that permits a banking entity to engage, in the context of a covered fund operated for fiduciary clients, in otherwise impermissible sponsoring activity, and transforms it into a prohibition on a banking entity organizing and offering a covered fund. The statute does not prohibit banking entities from organizing and offering covered funds that are not *sponsored* by the banking entity, nor does it prohibit employees, officers and directors from investing in covered funds that are not sponsored by the banking entity.

Moreover, for a banking entity that operates in a true fiduciary function, the fiduciary clients are interested in alignment of the interests of the client's account manager, and the team that develops the investment strategy and a recommended asset allocation for the client's fiduciary account, with the client's interests through the investment by the banking entities officers, employees and directors in the same categories of investments and funds. The recommendation and decision to invest the client's fiduciary account into the asset class and into the particular covered funds is at least as important as the investment decisions made at the fund level. The client is not simply interested in the alignment of the interests of the employees who service the covered fund with the client's interest, the client also wants to know that the persons (and their direct and indirect supervisors) who are recommending the asset class and particular covered fund also have "skin in the game." To the extent that the agencies impose the conditions to the "fiduciary fund" exemption, that exemption in the final rule should be broadened to permit directors and employees to invest in such covered funds without regard to whether the director or employee provides services directly to the covered fund.

See pages 3, 8-9, 12, and 14-20 of the attached Comment Letter for a discussion of this issue.

<u>Question 268.</u> Should the proposed rule be modified to permit a banking entity to bring its investments in covered funds into compliance with the proposed rule within a reasonable period of time if, for example, the banking entity's aggregate permitted investments in covered funds exceeds 3 percent of its tier 1 capital for reasons unrelated to additional investments (e.g., a banking entity's tier 1 capital decreases)? Why or why not?

Yes, as otherwise, the banking entity could be required to act hastily to divest illiquid assets at fire sale prices, causing the very loss that the Volcker Rule is designed to avoid.

<u>Question 269.</u> Does the proposed rule effectively and appropriately implement the deduction from capital for an investment in a covered fund contained in section 13(d)(4)(B)(iii) of the BHC Act? If not, what alternative approach would be more effective or appropriate, given the statutory language of the BHC Act and overall structure of section 13(d)(4), and why? What effect, if any, should the Agencies give to the cross-reference in section 13(d)(4) to section 13(d)(3) of the BHC Act, which provides Agencies with discretion to require additional capital, if appropriate, to protect the safety and soundness of banking entities engaged in activities permitted under section 13 of the BHC Act? How, if at all, should a banking entity's deduction of its investment in a covered fund be increased commensurate with the leverage of the covered fund? Should the amount of the deduction be proportionate to the leverage of the covered fund? For example, instead of a dollar-for-dollar deduction, should the deduction be set equal to the banking entity's investment in the covered fund times the difference between 1 and the covered fund's equity-to-assets ratio?

See pages 27-28 of the Comment Letter.

<u>Question 270.</u> Does the proposed rule effectively implement the Board's statutory authority to grant an extension of the period of time a banking entity may retain in excess of 3 percent of the ownership interests in a single covered fund? Are the enumerated factors that the Board may consider in connection with reviewing such an extension appropriate (including factors related to the effect of an extension of the covered fund), and if not, why not? Are there additional factors that the Board should consider in reviewing such a request? Are there specific additional conditions or limitations that the Board should, by rule, impose in connection with granting such an extension? If so, what conditions or limitations would be more effective?

See pages 28-29 of the Comment Letter.

<u>Question 271.</u> Given that the statute does not provide for an extension of time for a banking entity to comply with the aggregate funds limitation, within what period of time should a banking entity be required to bring its investments into conformance with the aggregate funds limit? Should the proposed rule expressly contain a grace period for complying with these limits? Why or why not? If yes, what grace period would be most effective and why?

The statute provides the Federal Reserve Board with authority to extend the period of time to comply with the aggregate funds limitation for investments made prior to the effective date of the Volcker Rule. Moreover, the statute provides broad authority for the agencies to exempt banking entities from any provision of the Volcker Rule where appropriate. We respectfully suggest that the agencies utilize both types of exemptive authority where appropriate to extend the time period within which to conform investments to the aggregate funds limitation. See pages 28-29 of the attached Comment Letter for a discussion of this issue.

<u>Question 281.</u> Is the proposed rule's approach to implementing the hedging exemption for acquiring or retaining an ownership interest in a covered fund effective? If not, what alternative approach would be more effective?

We suggest that the final rule permit investment to hedge obligations under non-qualified plans, without a restriction only to plans of banking entity employees directly involved in servicing the covered funds in which the hedging investment is made. This restriction is not imposed by the statute, but instead is an amalgam of the hedging exemption with other unrelated exemptions and serves no useful purpose. The restriction in the proposed rule does not benefit or protect fiduciary clients or further the safety and soundness of the banking industry. Instead, it detracts from the interests of fiduciary clients and undermines the safe and sound operations of banks by limiting the ability of a banking entity to align its employees interests with those of fiduciary clients and reduces the ability for banking entities to attract and retain qualified personnel. See pages 3, 8-9, 12, and 14-20 of the attached Comment Letter for a discussion of this issue.

<u>Question 282.</u> Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

See pages 3, 8-9, 12, and 14-20 of the Comment Letter.

<u>Question 283.</u> What burden will the proposed approach to implementing the hedging exemption have on banking entities? How can any burden be minimized or eliminated in a manner consistent with the language and purpose of the statute?

See response above to Question 281.

<u>Question 284.</u> Are the criteria included in § __.13(b)'s hedging exemption effective? Is the application of each criterion to potential transactions sufficiently clear? Should any of the criteria be changed or eliminated? Should other requirements be added?

See pages 3, 8-9, 12, and 14-20 of the Comment Letter.

<u>Question 285.</u> Is the requirement that an ownership interest in a covered fund may only be used as a hedge (i) by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, or (ii) to cover compensation arrangements with an employee of the banking entity that directly provides investment advisory or other services to that fund effective? If not, what other requirements would be more effective?

The restriction in the proposed rule to use of the hedging exemption solely to covering compensation arrangements with an employee of the banking entity who directly provides investment advisory or other services to that covered fund is inappropriate. The hedging exemption in the final rule should permit its use to hedge obligations of a banking entity under qualified or nonqualified plans for any officer, director or employee (including current or former employees).

See response above to question 281, and pages 3, 8-9, 12, and 14-20 of the attached Comment Letter for a discussion of this issue.

<u>Question 294.</u> Is the proposed exemption consistent with the purpose of the statute? Is the proposed exemption consistent with respect to national treatment for foreign banking organizations? Is the proposed exemption consistent with the concept of competitive equity?

On the whole, this aspect of the Volcker Rule's statutory provisions was not well thought through. The proposed rule does not improve upon the problem created by the statute. On the one hand, imposition of the Volcker Rule on foreign banking organizations, and on non-US affiliates of U.S. banks, may prove profoundly disruptive to foreign markets. On the other hand, creating a broader offshore exemption for foreign banks will provide a competitive edge to foreign banking entities, and will shift jobs and tax revenue to outside the U.S. and to foreign ownership, without reducing risk to investors or the financial services industry in any way.

<u>Question 311.</u> Should non-U.S. funds or entities be included in the definition of "covered fund"? Should any non-U.S. funds or entities be excluded from this definition? Why or why not? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the BHC Act?

Non-U.S. funds are not within the statutory definition of "covered funds," because they do not rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act for an exclusion from the definition of investment company under that Act. To the extent that the agencies choose to use their rulemaking authority to broaden out the definition to include foreign funds, it should be done more narrowly, and not include foreign funds that are pension or employee benefit plans, or that are publicly-offered or publicly traded outside the United States. See response to Questions 5 - 7 above.

<u>Question 321.</u> What implementation, operational, or other burdens or expenses might be associated with the compliance program requirement? How could those burdens or expenses be reduced or eliminated in a manner consistent with the purpose and language of the statute?

The compliance program requirements should be simplified and implemented over time in stages. See pages 29-30 of the Comment Letter and responses above to Questions 2-5.

<u>Question 373.</u> How will the proposed definition of "covered fund" affect a banking entity's investment advisory activities, in particular activities and relationships with investment funds that would be treated as "covered funds"? Please estimate any resulting costs or benefits or discuss why such costs or benefits cannot be estimated.

See pages 23-24 of the Comment Letter for a discussion of the potential impact of the proposed rule. It is difficult to assign a dollar value at this time to the costs and benefits, although we anticipate that the costs will be well in excess of what it set forth in the proposing release.

<u>Question 374.</u> How have banking entities traditionally organized and offered covered funds? What are the benefits and costs associated with the proposed requirements for relying on the exception for organizing and offering covered funds? Please estimate any resulting costs or benefits or discuss why such costs or benefits cannot be estimated.

See pages 4-8 of the Comment Letter.

__Question 376.__ **Is it common for a banking entity to share a name with the covered funds that it invests in or sponsors? If yes, what entity in the banking structure typically shares a name with such covered funds? What costs and benefits will result from the proposed rule's implementation of the name sharing requirement in exception for organizing and offering a covered fund? What alternatives, if any, may be more cost-effective while still being consistent with the purpose of the statute?**

See pages 7 and 13 of the Comment Letter.

__Question 377.__ **Under what circumstances do directors and employees of a banking entity invest in covered funds? What are the benefits and costs associated with the proposed provisions regarding director and employee investments in covered funds? What alternatives, if any, may be more cost-effective while still being consistent with the purpose of the statute?**

See pages 3, 8-9, 12, and 14-20 of attached Comment Letter for detailed discussion of this issue.