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Washington, D.C. 20219

Securities and Exchange Commission  
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Washington, D.C. 20551

Commodity Futures Trading Commission  
Three Lafayette Centre  
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Washington, D.C. 20581

Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

Re: Restrictions on Proprietary Trading and Certain Interests In, and Relationships With,  
Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada and The Toronto-Dominion Bank (together, the “Canadian Banks”; for purposes of this comment letter, this term also includes all affiliated “banking entities” of each, including particularly, the asset management affiliates), the five largest banks in Canada, appreciate this opportunity to provide comments on the Notice of Proposed Rulemaking (“Proposal”) regarding implementation of the “Volcker Rule” as set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)<sup>1</sup> which was jointly issued by the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (“Federal Reserve”), the Federal Deposit Insurance Corporation (“FDIC”) and the Securities and Exchange Commission (“SEC”) and subsequently joined by the Commodity Futures Trading Commission (“CFTC”) (collectively, the “Agencies”).<sup>2</sup> In addition to banking and other

<sup>1</sup> See Public Law 111–203, 124 Stat. 1376 (July 21, 2010).

<sup>2</sup> The Proposal was initially issued in October 2011 by four of the five Agencies and published in the Federal Register in November. See *Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds*, 76 Fed. Reg. 68846 (November 7, 2011). On January 13, 2012,

activities, the Canadian Banks have more than C\$527 billion dollars under management in a mix of Canadian regulated mutual funds (“Canadian Public Funds”), private pooled investment vehicles (“Canadian Private Funds”), including alternative funds, and segregated account mandates. Of the C\$773.7 billion Canadian Public Fund industry, the Canadian Banks sponsor<sup>3</sup> and manage approximately C\$321 billion.<sup>4</sup> Canadian Public Funds and Canadian Private Funds are hereinafter collectively referred to as “Canadian Funds.”

## EXECUTIVE SUMMARY

1. *The Agencies should adopt an exclusion for Canadian Public Funds from the proposed definition of “covered fund.”*<sup>5</sup>

In the absence of such an exclusion, the Proposal will have extraterritorial effects, not intended by Congress, that would seriously disrupt the market for Canadian Public Funds, either by (1) forcing Canadian Public Funds sponsored by the Canadian Banks to exclude all investors who might now or in the future be resident in the United States, in particular so-called “snowbirds” or other temporary residents who are not U.S. citizens; or (2) forcing the Canadian Banks to cease sponsoring and owning interests in Canadian Public Funds, largely because we are unable to determine whether or not persons deemed to be resident in the United States are fund investors (e.g., snowbirds, business travelers or persons who invest through omnibus accounts of third party intermediary brokerage firms). Given the close economic and other ties between Canada and the United States, these developments would significantly undermine the Canadian Public Funds market and significantly impair market liquidity in Canada as well as in the United States given trading by Canadian Public Funds in the U.S. securities market. The Volcker Rule, as enacted, excludes funds registered for public sale in the United States under the Investment Company Act of 1940, as amended (“Company Act”) (hereinafter, “US Public Funds”), but the Proposal fails to provide a similar exclusion for Canadian Public Funds from the proposed definition of “covered fund.” The extraterritorial effects violate principles of international comity, discriminate against Canadian Public Funds (that are generally unable to register under the Company Act), violate Canada’s rights under the North American Free Trade Agreement (“NAFTA”)<sup>6</sup> and are not justified by any evidence that Canadian Public Funds have been, or are expected to be in the future, a threat to the stability of the U.S. financial system which is one of the principal goals of the Volcker Rule.

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the CFTC issued its own version of the Proposal for institutions for which it is the primary federal financial regulator which has not yet been published in the Federal Register. The sections cited in this letter and the questions responded to are the same in both versions.

<sup>3</sup> The term “sponsor” as used in this letter refers to the defined term as used in the text of the Volcker Rule which means, among other things, “to share with a fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.” Section 13 of the Bank Holding Company Act of 1956 (“BHCA”) as added by Section 619 of Dodd-Frank, at Subsection 13(a)(1).

<sup>4</sup> According to the October 2011 Industry Overview published by the Investment Funds Institute of Canada (“IFIC”), the Canadian mutual fund industry has total assets under management of approximately C\$773.7 billion. Bank affiliated Canadian Public Funds constitute over C\$342 billion of this total, representing nearly half the industry.

<sup>5</sup> The Canadian Banks recognize that the same arguments should apply equally to similarly regulated non-Canadian foreign public funds (collectively, “Foreign Public Funds”) and would support the exemption of all Foreign Public Funds from the definition of “covered fund.” However, the primary focus of this letter is on issues affecting the Canadian Banks.

<sup>6</sup> North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 LL.M. 289 (1993).

2. *In recognition of the regulatory framework developed over decades by the SEC and its staff (“Staff”) to permit any Canadian Fund to meet the investment needs of non-US persons who spend time in the United States, including those who are temporary residents, the Agencies should exclude from the definition of “resident of the United States,” as used in the foreign fund exemption, Canadian “snowbirds” and others who are temporary U.S. residents.*

Under the Proposal, foreign funds (“Foreign Funds”) are exempt from the definition of “covered fund” to the extent that they are, among other things, purchased by and sold only to persons who are not deemed to be U.S. residents and sold only outside the United States (hereinafter, “foreign fund exemption”). However, the Canadian Banks would be unable to rely upon the foreign fund exemption to sponsor or maintain ownership interests in any Canadian Fund, to the extent that units<sup>7</sup> of the Canadian Fund are sold to any investors deemed to be a “resident of the United States” or to the extent that the Canadian Banks offer or sell Canadian Fund units through an affiliate, subsidiary or employee located in the United States, even if such sales are made to Canadian residents or residents of other foreign jurisdictions. If Canadian Public Funds are not excluded from the definition of “covered fund” as requested above, and if these conditions of the foreign fund exemption are not changed, Canadian Banks would effectively be precluded from continuing to sponsor or invest in Canadian Public Funds because they would be unable to meet the conditions of the foreign fund exemption.

3. *The Agencies should explicitly exempt from the definition of “affiliate” all permissible funds, whether or not they meet the definition of “covered fund,” to ensure that all permitted funds can trade for their own accounts, including making investments in other covered funds.*

As proposed, the term “affiliate” still covers a wide range of permitted “investment companies,” including covered funds permitted by an exemption (such as Foreign Funds) and funds and other corporate vehicles that do not rely solely on Company Act Section 3(c)(1) or 3(c)(7). An exemption is necessary to ensure that permitted funds may trade their own portfolios.

As discussed in more detail below, the Agencies have invited comment on the extraterritorial impact of the Volcker Rule and the extent to which the Proposal appropriately limits such effects. This letter (“Comment Letter”) focuses specifically on these extraterritorial issues. While this Comment Letter is written from the perspective of the Canadian Banks, we note that two of the requested changes would also apply to the Foreign Fund activities of U.S. banks.

### **Background on the Canadian Fund Industry**

The Canadian Banks are each chartered in Canada and subject to the provisions of the Bank Act (Canada). The Canadian Banks each have U.S. banking operations consisting of either insured depository institution subsidiaries or direct U.S. uninsured branches or agencies or both. These relationships trigger the application of the Volcker Rule. In addition, largely through

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<sup>7</sup> While Canadian Funds may be either corporations or trusts, the vast majority of such funds are organized as trust companies which issue units rather than corporations which issue shares. As a result, for purposes of this Comment Letter, we will generally refer to investments in Canadian Funds, whether Canadian Public Funds or Canadian Private Funds, as fund “units” and their investors as “unitholders” rather than “shareholders,” the term commonly used with respect to US Public Funds.

subsidiaries or affiliates, the Canadian Banks are engaged in various investment management and other securities activities in Canada, the U.S. and other countries.

The Canadian Banks collectively account for a significant portion of the Canadian fund market.<sup>8</sup> Each is involved in creating, sponsoring and/or managing families of Canadian Funds, including both publicly offered mutual funds and private pooled vehicles offered to accredited and/or institutional investors. Some of the Canadian Banks are also involved in creating, sponsoring or managing funds organized and offered in other foreign jurisdictions, both public and private.

The Canadian Banks are subject to extensive regulation in Canada. The investment management affiliates are required to be registered in various capacities, including Investment Fund Manager, Portfolio Manager and Exempt Market Dealer designations. Investment management affiliates of Canadian Banks are subject to various Canadian affiliated transaction and conflict of interest rules, including rules regarding cross trading, trading with affiliates, trading in securities of the affiliated bank, investing in new issuances of an affiliate and, particularly with respect to Canadian Public Funds, purchasing securities underwritten by an affiliate. In addition, some of the Canadian Banks have investment management affiliates regulated in other foreign jurisdictions for purposes of managing, distributing and/or sponsoring Foreign Funds.

Canadian Public Funds are publicly offered and distributed in Canada pursuant to a written Fund Facts and/or prospectus and annual information form (“AIF”), each of which must be filed with Canadian securities regulators and are governed under National Instruments (“NI”) 81-101, 81-102, 81-106 and 81-107, a regulatory scheme comparable to the Company Act. After filing and obtaining a receipt for the prospectus, the filer obtains the status of a “reporting issuer.” Reporting issuers are subject to a variety of ongoing disclosure and other rules. NI 81-107 and other Canadian regulations require each Canadian Public Fund to have an Independent Review Committee (“IRC”) comprised solely of independent individuals. Under NI 81-107, each fund manager must bring all material conflicts of interest, including material statutory and business conflicts, to the IRC for approval or recommendations.

Canadian Public Funds are not registered in the United States under the Company Act and are not publicly offered to U.S. persons. However, the Canadian Banks rely on exemptive rules issued by the SEC or on no-action relief granted by its Staff under Company Act Sections 3(c)(1) and/or 3(c)(7) to provide comfort that units of Canadian Funds, whether public or private, which are purchased or held by Canadian citizens who travel to or have vacation or retirement homes in the U.S., are not deemed to violate the Company Act’s restrictions on sales of Foreign Funds inside the United States. These individuals may from time to time engage in investing, reinvesting or otherwise managing their assets in these funds in reliance on relief provided by the SEC under Company Act Rule 7d-2 or on Staff no-action relief for Canadian retirees or part-time residents of the United States, otherwise known as “snowbirds.” As discussed below, exemptive relief has been in place in varying forms in this regard for a number of years.

Canadian Private Funds are not publicly offered for sale in the United States either, but may rely on Staff no-action relief in the same manner as Canadian Public Funds. Non-U.S. persons

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<sup>8</sup> See, e.g., text at note 4, *supra*.

eligible to invest in such funds may, from time to time, make or manage investments in such funds while traveling on business or otherwise visiting the United States.<sup>9</sup>

Many Foreign Public Funds are similarly regulated in other jurisdictions and, like their Canadian Public Fund counterparts, may rely on SEC Staff no-action guidance to allow certain individuals who may be considered U.S. residents to invest in their securities. Although no other foreign jurisdiction enjoys the rich regulatory history shared by the SEC and the Canadian Fund industry, Foreign Funds from other jurisdictions, both public and private, are generally eligible to rely on the comfort provided by Staff no-action letters granted under Company Act Sections 3(c)(1) and 3(c)(7) to permit certain limited investment activities involving U.S. residents.

### **I. Exclude Canadian Public Funds from the Definition of “Covered Fund”**

The Proposal fails to expressly exclude Canadian Public Funds from its newly created term “covered fund,” which encompasses hedge funds, private equity funds and certain similar funds.<sup>10</sup> Foreign Funds sponsored by foreign banking entities may qualify for exemption from the definition in reliance on the proposed foreign fund exemption, but only if all transactions of each such fund occur “solely outside the United States.”<sup>11</sup>

We submit that the term “covered fund” as currently defined is too broad. With respect to Foreign Funds, the Agencies indicated that they only intended to include as “‘similar funds’ . . . the *foreign equivalent* of any entity identified as a ‘covered fund.’”<sup>12</sup> Under this rationale, Canadian Public Funds should be excluded from the Volcker Rule to the same extent that US Public Funds are excluded, even if, as a matter of cross-border securities law compliance, they

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<sup>9</sup> Canadian Private Funds may also occasionally be sold on a true private placement basis to U.S. persons who are qualified purchasers or accredited investors as those terms are defined under the U.S. securities laws. While such funds would not be exempt under the foreign fund exemption, we note that preventing U.S. persons from investing in Canadian Private Funds on a private placement basis would appear to violate NAFTA §1404(2) because the U.S. did not reserve to itself the right to derogate from this provision in Annex B of NAFTA. *See infra* text accompanying notes 22-24.

<sup>10</sup> The Canadian Banks previously requested the exclusion of Canadian Public Funds from the definitions of “hedge fund” and “private equity fund” in any future rulemaking proposal to implement the Volcker Rule in a submission to the Financial Stability Oversight Council. *See Comment from The Toronto-Dominion Bank, on behalf of itself, BMO, BNS, CIBC, and RBC, the five largest Canadian Banks*, Document ID: FSOC-2010-0002-1296, Public Submission on Notice: Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds (November 5, 2010) available at <http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1296>.

<sup>11</sup> Proposed Rule §\_\_13(c)(1)(iv), Proposal, *supra* note 2, at 68954. To be deemed solely outside the U.S., the transactions must satisfy all of the following conditions:

- The transaction or activity is conducted by a banking entity that is not organized under the laws of the United States or of one or more States;
- No subsidiary, affiliate, or employee of the banking entity that is involved in the offer or sale of an ownership interest in the covered fund is incorporated or physically located in the United States; and
- No ownership interest in such covered fund is offered for sale or sold to a resident of the United States.

*Id.* at 68911.

<sup>12</sup> *Id.* at 68897 (emphasis added).

may need to rely on Company Act Section 3(c)(1) or 3(c)(7) as interpreted by the SEC or its Staff.<sup>13</sup>

Yet, as drafted, the Proposal includes “any issuer that would be an investment company. . . but for section 3(c)(1) or 3(c)(7) . . . organized or offered outside of the United States, that would be a covered fund as defined . . . [in this §\_\_.10(b)(1)], were it organized or offered under the laws, or offered to one or more residents, of the United States or of one or more States.”<sup>14</sup> In explaining this provision, the Proposal reiterated that it would include any “issuer that would be an investment company, as defined in the . . . Company Act . . . , *but for* section 3(c)(1) or 3(c)(7) of that Act.”<sup>15</sup> Based on the Agencies’ explanation of the proposed rule, every Canadian Public Fund that relies upon Company Act Sections 3(c)(1) and/or 3(c)(7) to protect occasional offers or sales to investors that could be considered U.S. residents would be a covered fund.

The Canadian Public Funds may rely upon Company Act Sections 3(c)(1) and/or 3(c)(7) to protect such occasional offers or sales as a result of periodic vacation residency or business-related temporary residency in the U.S. They also rely upon these provisions to protect them with respect to unknown investors who may invest through omnibus accounts of third-party intermediary broker-dealers who are not required to disclose the identities of underlying accountholders in their omnibus accounts. “Covered fund” would reach all Canadian Public Funds which rely on either of these provisions to cover transactions by such investors.

#### A. Excluding Canadian Public Funds Would Be Consistent With Principles of International Comity Without Threatening the Stability of the US Markets

While perhaps unintended, if interpreted as summarized in the Proposal, including Canadian Public Funds as covered funds is inconsistent with principles of international comity. Subjecting banking entities that sponsor or have ownership interests in Canadian Public Funds to the severe consequences of the Volcker Rule while at the same time excluding US Public Funds would unfairly penalize an international industry that has not been found to have negatively affected the stability of U.S. financial markets or U.S. banks.

In pertinent part, the Volcker Rule prohibits any “banking entity”<sup>16</sup> from acquiring or retaining any “equity, partnership, or other ownership interest in or sponsor[ing] a hedge fund or private

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<sup>13</sup> Only Foreign Funds that are essentially the equivalent of a “hedge fund” or “private equity fund” as defined in Dodd-Frank should be within the definition. See Dodd-Frank §619(h)(2) which defines the terms “hedge fund” and “private equity fund” to mean any issuer that would be an investment company, as defined in the . . . [Company Act], but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate [Agencies] . . . may, by rule . . . determine.” Dodd-Frank, *supra* note 1, at 1630.

<sup>14</sup> Proposed Rule §\_\_.10(b)(1)(iii).

<sup>15</sup> Proposal, *supra* note 2, at 68897 & n.225 (emphasis in original).

<sup>16</sup> Under the Volcker Rule, “banking entity” is defined, in pertinent part, as “any insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. §1813)), any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity.” Section 13 of the Bank Holding Company Act of 1956 (“BHCA”) as added by Section 619 of Dodd-Frank, at Subsection 13(h)(1). The Proposal limits the term “banking entity” by excluding “any affiliate or subsidiary of a banking entity, if that affiliate or subsidiary is (i) a covered fund, or (ii) any entity controlled by such a covered fund.” Proposal, *supra* note 2, at 68855. See also, Proposed Rule §\_\_.2(e)(4). While this change would have a salutary effect with respect to proprietary trading by covered funds, it does not address the fact that, in order to promote a level

equity fund”<sup>17</sup> unless an exemption applies. To “sponsor” means, among other things, “to share with a fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.”<sup>18</sup>

The Proposal’s attempt to limit the impact of the Volcker Rule on Foreign Funds by creating the foreign fund exemption does not level the playing field for Canadian Public Funds vis-à-vis US Public Funds.<sup>19</sup> It should also be noted that the foreign fund exemption does nothing to protect ownership or sponsorship of Canadian Public Funds by U.S. banks. By defining covered funds primarily as funds that would be considered investment companies under the Company Act but for Sections 3(c)(1) or 3(c)(7), the Volcker Rule and the Proposal permit any banking entity, whether domestic or foreign, both to own significant interests in and to sponsor any US Public Fund regardless of who invests in such funds or where fund shares are sold, because these funds do not rely on either Company Act Section 3(c)(1) or 3(c)(7) and are, therefore, outside the scope of covered fund. Thus, shares of US Public Funds may be sold to residents of any jurisdiction in the world that permits such sales, whether on a public or private placement basis.

If the Proposal is adopted as drafted, however, both foreign banks and U.S. banks would be prohibited from sponsoring or having significant ownership interests in Canadian Public Funds. We see no policy justification under the Volcker Rule to preclude Canadian Public Funds from receiving the same treatment as US Public Funds simply because: (1) such funds currently rely on relief granted by the SEC and its Staff under Company Act Sections 3(c)(1) and/or 3(c)(7) to ensure that some investors who may be considered U.S. persons may hold ownership interests in the funds without violating the Company Act’s statutory prohibition on the public sale of any Foreign Fund securities in the United States; and (2) nearly every Foreign Fund, whether public or private, faces the likelihood that a non-U.S. person may be temporarily or otherwise considered a U.S. resident as a result of transactions made while such persons are traveling, whether on business or pleasure, inside the United States. Yet, under the Proposal, the Canadian Banks will be required to divest themselves of all ownership interests in and sponsorship of Canadian Public Funds if they fail to satisfy all three conditions of the foreign fund exemption (*e.g.*, if there are any U.S. resident investors or sales of such funds by any person located in the United States, even if such sales are made solely to residents of non-U.S. jurisdictions).<sup>20</sup> Moreover, U.S. banks would have to divest themselves of any sponsorship interest in a Canadian Public Fund because they are not eligible for the proposed foreign fund exemption in the first instance.

Absent an exclusion for Canadian Public Funds, the Volcker Rule will have several unintended consequences. First, it will disrupt the existing global market for offers, sales and sponsorship of

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playing field between U.S. Public Funds and Foreign Public Funds, Foreign Public Funds should be excluded from the definition of “covered fund.”

<sup>17</sup> Dodd-Frank *supra* note 1, §619 (to be codified at BHCA § 13(a)(1) (12 U.S.C. 1851)).

<sup>18</sup> *Id.* (to be codified at BHCA § 13(h)(5)(C) (12 U.S.C. 1851)). See also Proposed Rule §\_\_10(b)(5) which includes the same definition of “sponsor.”

<sup>19</sup> As discussed in Section II, below, the foreign fund exemption is unworkable because it exempts only those Foreign Funds sponsored by foreign banking entities which have no investments made by investors which could be deemed U.S. residents for whatever reason.

<sup>20</sup> See *supra* note 11, citing Proposal, *supra* note 2, at 68911(which states: “§1.13(c)(3) of the proposed rule provides that a transaction or activity will be considered to have occurred solely outside of the United States only if all of the following three conditions are satisfied . . .” (emphasis added)).

Canadian Public Funds by both the Canadian Banks and U.S. banks thereby reducing market liquidity worldwide. It could, in fact, result in the diminution or dismantling of Canadian Public Funds where a significant portion of such funds are offered and sold by the Canadian Banks, even though already subject to well-regulated foreign securities markets.

Second, it will place the Canadian Banks at a significant competitive disadvantage with respect to sales of securities of Canadian Public Funds they sponsor versus sales of US Public Funds by U.S. banks. U.S. banks will be able to continue to offer, sell, sponsor and maintain significant ownership interests in US Public Funds globally without regard to the Volcker Rule, while banks that sponsor Canadian Public Funds will be unable to escape its restrictions no matter how limited their transactions with U.S. persons may be.<sup>21</sup> In the absence of any finding that Canadian Public Funds had or are expected to have any destabilizing effect on the U.S. financial system, this result is especially unwarranted.

Third, the Proposal would force the Canadian Banks either to reject all investors deemed to be U.S. residents or divest themselves of their Canadian and other Foreign Public Funds, hurting the Canadian Banks and giving an unfair advantage to fund sponsors, including U.S. entities, that are not affiliated with any bank. While the Canadian Banks may continue to sponsor any Foreign Public Funds that satisfy the foreign fund exemption, we will be unable to use a unified trade name or brand on a global basis, while non-bank fund sponsors may continue to brand their financial products globally. We submit that the Volcker Rule was not intended to subject foreign banks to discriminatory prohibitions that do not apply to U.S. or foreign nonbank entities that operate globally in the investment management and fund industry.

Fourth, failure to exclude Canadian Public Funds from the Volcker Rule would violate NAFTA, a U.S. trade agreement to which Canada is a party (“Party”). Under NAFTA, each Party “shall permit persons located in its territory, and its nationals wherever located, to purchase financial services from cross-border financial service providers of another Party located in the territory of that other Party or of another Party located in the territory of that other Party or of another Party.”<sup>22</sup> However, under the Proposal, any person deemed to be within the definition of “resident of the United States” is effectively prohibited from purchasing or selling interests in Canadian Public Funds sponsored by Canadian Banks, including persons who are Canadian citizens temporarily residing in the U.S.

The Volcker Rule allows both U.S. and foreign banks to sponsor, own and sell shares of US Public Funds without interference, but under the Proposal, Canadian Public Funds would receive less favorable treatment because they are not similarly excluded from the definition of “covered fund.” NAFTA Section 1405 provides, in pertinent part, that “[e]ach Party shall accord to financial institutions of another Party and to investments of investors of another Party in financial institutions treatment no less favorable than that it accords to its own financial institutions and to investments of its own investors in financial institutions, in like circumstances,

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<sup>21</sup> Among other things, failing to exclude Canadian and other Foreign Public Funds from the definition of “covered fund” will subject all banking entities that offer such funds to the so-called Super 23A prohibitions set forth in Proposed Rule §\_\_.16. Our requested exclusion will relieve all such fund sponsors from these prohibitions. We understand that the Institute of International Bankers (“IIB”) plans to submit an extensive comment letter on the Proposal with respect to Super 23B. We support the principles expected to be espoused in the IIB comment letter.

<sup>22</sup> NAFTA, *supra* note 6, at §1404(2).



with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments” and “where a Party permits the cross-border provision of a financial service it shall accord to the cross-border financial service providers of another Party treatment no less favorable than that it accords to its own financial service providers, in like circumstances, with respect to the provision of such service.”<sup>23</sup> In contrast to the treatment of US Public Funds, the Proposal would prohibit Canadian Banks from owning, sponsoring or selling Canadian Public Funds to the extent that they may be purchased by persons within the definition of “resident of the United States” or offered or sold by a person located in the U.S. This differing treatment between US Public Funds and Canadian Public Funds directly contravenes NAFTA national treatment obligations. Considering that Canadian Public Funds are a core product offering of Canadian-based financial institutions, in the same way that US Public Funds are a core product offering of financial institutions primarily based in the U.S., Canadian Banks’ ability to deal with our core products on a level playing field is clearly prejudiced by the discriminatory definition of “covered fund.”

We are not suggesting that NAFTA be construed to prevent a Party from adopting prudential regulations, including reasonable measures intended to ensure the integrity or stability of a Party’s financial system.<sup>24</sup> In this case, however, application of the Volcker Rule to Canadian Public Funds cannot be considered reasonable measures because no evidence has been presented which suggests that Canadian Public Funds contributed, or might have a tendency to contribute in the future, to instability in the U.S. financial system. By the same token, there is no evidence that prohibiting the Canadian Banks from sponsoring, owning or selling either Canadian or other Foreign Public Funds to snowbirds or certain other U.S. residents would protect the safety and soundness of banking entities or the stability of the U.S. financial system. Without any apparent foundation, the Proposal confers preferential treatment on US Public Funds.

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<sup>23</sup> *Id.* at §§1405(2) and (3), respectively. If a Canadian Public Fund is considered a “financial institution” as defined by NAFTA §1416, then it would be covered by §1405(2); otherwise, it would be covered by §1405(3). Section 1405(5) elaborates that “[a] Party’s treatment of financial institutions and cross-border financial service providers of another Party, whether different or identical to that accorded to its own institutions or providers in like circumstances, is consistent with paragraphs 1 through 3 if the treatment affords equal competitive opportunities. Section 1405(6) further clarifies that “[a] Party’s treatment affords equal competitive opportunities if it does not disadvantage financial institutions and cross-border financial services providers of another Party in their ability to provide financial services as compared with the ability of the Party’s own financial institutions and financial services providers to provide such services, in like circumstances.” Here, “equal competitive opportunities” are plainly *not* being afforded.

<sup>24</sup> *Id.* at §1410(1) provides:

Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as:

- (a) the protection of investors, depositors, financial market participants, policyholders, policy claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service provider;
- (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers; and
- (c) ensuring the integrity and stability of a Party’s financial system.

## A. Analysis of Relevant Questions

Addressing Questions 221, 224, 225, 253, 294 and 311

Several questions in the Proposal are relevant to the issue of the treatment of Canadian and other Foreign Public Funds. For example, Question 221 inquired whether the definition of “covered fund” should 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),<sup>25</sup> and Question 224 inquired whether non-U.S. funds should be defined by reference to structural characteristics, including whether they operate without regard to statutory or regulatory requirements.<sup>26</sup> Question 225 inquired whether “any entities . . . 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?”<sup>27</sup> Similarly, Question 311 asked, in pertinent part, whether “non-U.S. funds or entities [should] 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?”<sup>28</sup>

As stated above, we believe that Canadian Public Funds should be excluded from the definition of “covered fund.” Capturing any Foreign Public Funds, just because some investors may be considered U.S. residents, is not only inconsistent with the purpose of the statute, but appears to be inconsistent with the Agencies’ intent.<sup>29</sup>

In specific response to these questions, we submit that Canadian Public Funds should be treated the same as US Public Funds for several reasons. First, Canadian Public Funds are equivalent to US Public Funds; they are not the “foreign equivalent” of covered funds. Like US Public Funds, Canadian Public Funds are subject to substantive regulatory regimes intended to protect investors. Canadian Public Funds are fully regulated under Canadian law and sold pursuant to a written disclosure document; their units are eligible for public sale; they are required to make disclosures to investors and regulators; and they are subject to extensive regulation to protect investors and avoid conflicts of interest with affiliates. It is unreasonable to treat such funds as covered funds. In addition, no policy reason of which we are aware would require the creation of such an unlevel playing field between banking entities that primarily own and/or sponsor US Public Funds which may include both US and foreign investors, and the Canadian Banks that primarily own and/or sponsor Canadian Public Funds simply because they may include certain investors deemed to be U.S. residents in reliance upon Sections 3(c)(1) and/or 3(c)(7).

Second, to the extent that Foreign Public Funds are deemed to be covered funds, the proposed foreign fund exemption would be largely unavailable to any foreign banking entity with an ownership interest in or sponsorship of such funds, because most have relied, at least from time to time, on existing SEC Staff no-action relief to allow certain non-U.S. persons who hold investments in their funds and who subsequently become or may be deemed to be U.S. residents to maintain or otherwise manage existing investments in Foreign Public Funds after attaining U.S. resident status. Absent clarification that Foreign Public Funds are not included in the definition of “covered funds,” nearly every banking entity with an ownership interest in or

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<sup>25</sup> See Proposal, *supra* note 2, at 68898.

<sup>26</sup> See Proposal, *supra* note 2, at 68899.

<sup>27</sup> *Id.*

<sup>28</sup> Proposal, *supra* note 2, 68915.

<sup>29</sup> See text related to note 12, *supra*, quoting Agencies’ statement of intent.

sponsorship of such funds would have to either: (1) take its brand name off all sponsored Foreign Public Funds and divest itself of its ownership interest in any such fund pursuant to the divestiture procedure under Dodd-Frank and the Proposal; or (2) redeem or otherwise transfer the holdings of any Foreign Public Fund investor considered to be a U.S. resident.<sup>30</sup>

Third, our recommendation would not create any differential treatment of foreign or U.S. banking entities under the Volcker Rule. To the extent that Canadian Public Funds are treated like US Public Funds rather than like covered funds, both U.S. and foreign banks and their affiliates would be equally entitled to invest in and sponsor such funds. Banking entities, whether U.S. or foreign, should be permitted to maintain ownership interests in and sponsor Foreign Public Funds regardless of whether certain U.S. residents may invest in such funds in reliance on Sections 3(c)(1) or 3(c)(7). We therefore recommend that the Proposal be modified to exclude from the Volcker Rule all Canadian Public Funds and other Foreign Public Funds, to the extent that such funds are regulated under the laws of a foreign jurisdiction and offer and sell their securities pursuant to written disclosure documents. In no event should Canadian Public Funds be treated as covered funds and no banking entity, whether U.S. or foreign, should be required to divest any ownership interest in or sponsorship of Canadian Public Funds solely because units of Canadian Public Funds may also be sold or offered for sale on a private placement basis to certain U.S. residents.

In addition, Question 294 sought input on whether the proposed foreign fund exemption is “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?”<sup>31</sup> We submit that the proposed foreign fund exemption is inconsistent with each of the suggested goals. Not only is it too limited to provide foreign banks protection from the onerous consequences of the Volcker Rule in relation to Foreign Public Funds subject to substantive regulation by foreign regulatory authorities, it is also inherently inconsistent with the purpose of the statute and principles of international comity.

#### B. Excluding Canadian Public Funds Would Be Consistent With SEC No Action Relief Without Harming US Markets

Excluding Canadian Public Funds from treatment as covered funds is consistent with longstanding positions of the SEC and its Staff under the Company Act. Failure to exclude Canadian Public Funds will undermine the carefully crafted regulatory scheme to adapt the Company Act to the realities of the growing economic and business integration of Canada and the United States.

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<sup>30</sup> See Proposed Rule §\_\_.10(a) and §\_\_.12. It is unclear whether Canadian Funds even have the authority to force unitholders to redeem, sell or otherwise transfer units in most situations. To the extent that such actions may be unlawful either under Canadian regulations or under the organizational documents of the funds, the potentially draconian implications of the Volcker Rule would be magnified because banking entities which sponsor or have ownership interests in such funds would have no option other than to divest themselves of such interests. In addition, the potential adverse consequences to investors, including taxes and loss of investment exposure, would have a negative impact on the reputation of the Canadian Banks.

<sup>31</sup> Proposal, *supra* note 2, at 68912.

It is well known that Company Act Section 7(d) imposes a significant statutory impediment to the public offer and sale of securities of any Foreign Fund in the United States.<sup>32</sup> It prohibits any “investment company, unless organized or otherwise created under the laws of the United States or of a State” to “make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, any security of which such company is the issuer” unless the SEC issues an order permitting such a company to register and make a public offering of its securities in the United States.<sup>33</sup>

Despite this statutory hurdle, the SEC and its Staff have long recognized that other jurisdictions may have laws requiring fund regulation that are similar to the Company Act. This recognition is particularly long-standing with respect to Canadian Public Funds. In 1954, the SEC adopted Company Act Rule 7d-1 to facilitate U.S. registration by Canadian management investment companies.<sup>34</sup> However, Rule 7d-1 ultimately failed to facilitate the *public* offer or sale of either Canadian Public Funds or other Foreign Public Funds in the U.S. because of other differences between U.S. and foreign laws.<sup>35</sup> As a result of the statutory prohibition in Section 7(d) and the largely insurmountable barriers posed by Rule 7d-1, Canadian Public Funds, even if subject to the full panoply of regulations available in their home jurisdiction, cannot be publicly offered in the U.S. and are thus rarely available to U.S. residents.

After Rule 7d-1 failed to open the U.S. market to Foreign Funds, the SEC and its Staff provided Foreign Funds with interpretive relief allowing limited *private* offerings of such funds to certain U.S. residents in the interests of international comity. For several years, the Foreign Fund industry relied on the *Touche Remnant* doctrine,<sup>36</sup> which interpreted Section 7(d) to permit a Foreign Fund to make a U.S. private offering as long as its shares did not end up being beneficially owned by more than 100 U.S. investors, the total number of investors permitted

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<sup>32</sup> Company Act Section 7(d) requires any investment company organized under the laws of a foreign country to obtain an order from the SEC permitting it to register under that Act before using the U.S. mails or any means or instrumentality of interstate commerce in connection with a public offering of its securities. The SEC is required to find both that registration of the Foreign Fund is consistent with the public interest and protection of investors and that it is legally and practically feasible to enforce the provisions of the Company Act against the fund before issuing any such order to the fund. 15 U.S.C. §80a-7(d).

<sup>33</sup> *Id.*

<sup>34</sup> See Company Act Rule 7d-1, 17 C.F.R. §270.7d-1, 19 Fed. Reg. 2585 (May 5, 1954). This rule specifies the conditions that a Canadian Fund must meet to satisfy the standards incorporated into Section 7(d) as described in note 32, above. Although limited on its face to Canadian management investment companies, the SEC left the door open to applications by funds organized under the laws of other jurisdictions, stating: “Conditions and arrangements proposed by investment companies organized under the laws of other countries will be considered by the Commission in the light of the special circumstances and local laws involved in each case.” *Id.* at Subsection 7d-1(a).

<sup>35</sup> While well-intentioned, the rule proved insufficient to meet the needs of Canadian or other Foreign Public Funds seeking to sell their shares to U.S. investors, primarily due to intractable differences between U.S. and foreign laws, such as which jurisdiction’s rules take priority in the event of a specific conflict and how shares of a foreign domiciliary fund owned by U.S. investors would be treated in the bankruptcy courts of the fund’s local jurisdiction. These differences are largely irrelevant to the fiscal integrity of the U.S. banking system and should not be an impediment to excluding Canadian Public Funds from covered funds under the Volcker Rule.

<sup>36</sup> See *Touche Remnant & Co.*, SEC No-Action Letter (Aug. 27, 1984) (“*Touche Remnant*”). *Touche Remnant* limited only the number of U.S. investors who could participate in a Foreign Fund; it did not limit the number of non-U.S. investors who could invest in such funds.

under Section 3(c)(1) for a U.S. fund to avoid registration under the Company Act.<sup>37</sup> In 1997, the Staff expanded the *Touche Remnant* doctrine to allow Foreign Funds to include an unlimited number of U.S. “qualified purchasers” in reliance on Section 3(c)(7).<sup>38</sup>

The SEC Staff granted additional no-action relief in response to a request from the *Investment Funds Institute of Canada* (“IFIC”), the trade association for Canadian Public Funds.<sup>39</sup> Popularly known as the “snowbird” letter, the SEC Staff stated in the *IFIC Letter* that it would not recommend enforcement action under Section 7(d) if a Canadian Public Fund that offered its securities privately to U.S. investors in reliance on Section 3(c)(1) had more than 100 U.S. securityholders solely as a result of either: (1) the relocation of non-U.S. securityholders to the U.S.; or (2) offshore secondary market transactions not involving the Foreign Fund or its agents, affiliates or intermediaries. Further, *Goodwin I*, the 1997 Staff no-action relief which expanded the *Touche Remnant* doctrine to include 3(c)(7) funds, also expanded the “snowbird” doctrine from the *IFIC Letter* to cover all “investment companies organized outside of the United States” offered or sold on a private placement basis in the U.S., not just Canadian Public Funds.<sup>40</sup>

Additional conditions were attached to the relief granted to IFIC, primarily to ensure that Canadian Public Funds would not be engaging in activities that could reasonably be expected or intended to “condition” the U.S. market with respect to the funds’ securities for the purpose of establishing a trading market for such securities in the U.S. However, Foreign Funds meeting the conditions may continue to use U.S. jurisdictional means to provide certain services to U.S. investors, including sending securityholder reports, account statements, proxies and other reports. Under the *IFIC Letter*, snowbirds may also participate in automatic reinvestment

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<sup>37</sup> See, e.g., *Resale of Restricted Securities*, SEC Release No.33-6862 (Apr. 23, 1990) [55 Fed. Reg. 17933 (April 30, 1990)] at text following n.64; *Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts*, SEC Release Nos. 33-7656, 34-41189 and IC-23745 (proposed March 19, 1999) [64 Fed. Reg. 14648 (March 26, 1999)] (hereinafter, “*Canadian Retirement Release*”) at n.10; Goodwin, Proctor & Hoar, SEC No-Action Letter (Feb. 28, 1997) (“*Goodwin I*”); Investment Funds Institute of Canada, SEC No-Action Letter (Mar. 4, 1996) (“*IFIC Letter*”); and *Touche Remnant*, *supra*, note 36.

<sup>38</sup> See *Goodwin I*, *supra* note 37. “Qualified Purchaser” is defined in Company Act Section 2(a)(51) and incorporated by reference in Company Act Section 3(c)(7).

<sup>39</sup> See *IFIC Letter*, *supra* note 37.

<sup>40</sup> The SEC Staff expressly expanded this position to include foreign funds relying on 3(c)(7) in two no-action letters issued to Goodwin, Proctor & Hoar. See *Goodwin I*, *supra* note 37, and Goodwin, Proctor & Hoar, SEC No-Action Letter (Oct. 5, 1998) (“*Goodwin II*”) at n.8 (“We note that if U.S. persons become shareholders of a Foreign Fund as a result of activities beyond the control of the fund or persons acting on its behalf, the fund would not be required to count those shareholders as U.S. persons for purposes of determining whether it may rely on Section 3(c)(1) or 3(c)(7) of the Act.” (citing the *IFIC Letter* and SEC Release No. IC-23071 (Mar. 23, 1998))). In 2011, the SEC took official cognizance of its Staff’s positions in *Touch Remnant*, *Goodwin I* and the *IFIC Letter* in adopting rules to implement certain Dodd-Frank amendments to the Investment Advisers Act of 1940, as amended (“Advisers Act”). See *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers*, SEC Release No. IA-3222 (June 22, 2011) [76 Fed. Reg. 39646 (July 6, 2011)] (hereinafter “*SEC Exemptions Release*”) at nn.294 & 480.

The proposed foreign fund exemption would appear to support the proposition that a Foreign Fund would not be deemed to have offered for sale or sold fund units to a U.S. resident solely because foreign citizens who became unitholders of such funds while residing in Canada or another foreign jurisdiction subsequently relocated to the U.S. See Proposal, *supra* note 2, at 68910-68911. However, it does not appear to support the proposition that temporary U.S. residents can manage their Foreign Fund investments while in the U.S. as permitted by the *IFIC Letter*, Company Act Rule 7d-2 or the *SEC Exemptions Release*.

programs which, absent such relief, would be considered sales to U.S. residents. The SEC also adopted Company Act Rule 7d-2, which granted further exemptive relief to Canadian Funds for certain kinds of fund investors.<sup>41</sup> This rule codified and expanded upon certain aspects of the *IFIC Letter* by giving official recognition to the fact that participants in Canadian retirement plans who are unitholders of any Canadian Fund and either relocate to the U.S. or are temporarily present in the U.S. should be permitted to manage their investments in such Canadian Funds regardless of their location without causing the Canadian Funds in which they are invested to be deemed to have made a public offering in the U.S. in violation of Section 7(d).

When read together, the guidance issued by the SEC and its Staff makes clear that even in the face of an obstacle as formidable as Section 7(d), Foreign Funds were never intended to be completely unavailable to U.S. investors.<sup>42</sup> Both the *IFIC Letter* and Rule 7d-2 were cited by the SEC in support of its adoption of rules to implement the foreign private adviser exemption from registration under the Investment Advisers Act of 1940, as amended (“Advisers Act”) which was added to the Advisers Act by Dodd-Frank.<sup>43</sup> In the absence of convincing evidence that Canadian Public Funds had or are expected to have a negative impact on U.S. financial markets, the Volcker Rule should not disrupt a long-settled policy that has successfully governed the Canadian Public Fund industry simply because a banking entity happens to have an ownership interest in, sponsor or, even more remotely, be affiliated with foreign entities which manage funds offered for public sale under the laws of a foreign jurisdiction which are comparable to the Company Act.

Treating Canadian Public Funds as covered funds would undermine the entire SEC framework for accommodating Canadian Public Funds, at least with respect to those sponsored by foreign banking entities. Including Canadian Public Funds within the definition of “covered fund” simply because they may have some U.S. resident investors protected by Section 3(c)(1) and/or 3(c)(7) or by an SEC or Staff interpretive position of these Sections would stand SEC precedent on its head. While this may indeed be the Agencies’ intent with respect to Foreign Private Funds that more closely resemble a “hedge fund” or “private equity fund” as defined in the Volcker Rule, it is not reasonable to apply the same rationale to Canadian or other Foreign Public Funds, which are closely akin to US Public Funds, simply because they may rely on Sections 3(c)(1) and/or 3(c)(7) for protective purposes.

Failure to treat Foreign Public Funds in the same manner as US Public Funds would have the effect of imposing the draconian consequences of the Volcker Rule extraterritorially on the Canadian Banks and all foreign banking entities sponsoring funds subject to regulation under local statutes generally comparable to the Company Act. These Foreign Public Funds would either have to: (1) take extraordinary steps to insure the exclusion all U.S. residents from

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<sup>41</sup> See Rule 7d-2, 17 C.F.R. §270.7d-2, 65 Fed. Reg. 37672 (June 15, 2000). See also, *Canadian Retirement Release*, *supra* note 37, adopting Company Act Rule 7d-2.

<sup>42</sup> See *IFIC Letter*, *supra* note 37 (“The legislative history of the Investment Company Act indicates that, despite Section 7(d), Congress anticipated that there would be some ‘leakage’ of foreign fund securities into the United States” (citing SEC DIVISION OF INVESTMENT MANAGEMENT, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION (May 1992) at 213 & n.76; and Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcom. of the Senate Com. on Banking and Currency, 76<sup>th</sup> Cong., 3d Sess. at 199 (1940)).

<sup>43</sup> See *SEC Exemptions Release*, *supra* note 40.

investing and/or reinvesting in the funds; or (2) register the funds with the SEC which, as a practical matter, is not feasible.<sup>44</sup>

With respect to attempting to exclude all U.S. residents, it may be impermissible, either under foreign regulations or the organizational documents of the funds, to force existing investors to redeem, sell or transfer their fund units upon relocation. Moreover, Canadian Public Funds do not control or necessarily know when or if their investors travel through or relocate to the U.S. and may not have access to any information about the residency of investors who invest in the funds through an omnibus account of an unaffiliated broker-dealer. Canadian Public Funds would thus be subjected to all of the negative consequences of the Volcker Rule due to circumstances outside the control of the Canadian Banks.

The SEC and its Staff have recognized the challenges faced by sponsors and managers of US Public Funds in identifying individual shareholders whose shares are held through omnibus accounts of third party financial intermediaries and have granted relief in both rules and no-action letters. For example, in amending Company Act Rule 22c-2, the SEC acknowledged concerns about how “as a practical matter, a fund could obtain shareholder information through multiple layers of intermediaries,” and particularly noted the difficulty of identifying individual shareholders of mutual funds in the case of shares held through “chains,” or multiple layers, of intermediaries, in which broker-dealers hold US Public Fund shares on behalf of other intermediaries.<sup>45</sup> Similarly, in adopting Advisers Act Rule 206(4)-5, also known as the “Pay-to-Play” Rule, the SEC noted the potential difficulty faced by investment advisers in identifying government plan shareholders when plan accounts are held through an intermediary.<sup>46</sup> The Staff subsequently granted no-action relief from certain aspects of the Pay-to-Play Rule’s recordkeeping requirements in cases where, due to the lack of transparency caused by omnibus accounts, an investment adviser may be unable to identify government entity shareholders who hold shares in a US Public Fund.<sup>47</sup> The Canadian Banks face the exact same issue with respect to omnibus accounts invested in units of Canadian Public Funds or other Foreign Public Funds. It is essentially impossible for the Canadian Banks to know every fund unitholder because third party broker-dealer intermediaries are under no legal or regulatory obligation to provide information on underlying investors in their omnibus accounts.

The SEC and its Staff have implemented workable conditions enabling Foreign Funds, whether public or private, to maintain a limited number of U.S. resident investors without forcing such funds either to exclude all such investors or exit the U.S. market. These conditions are even

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<sup>44</sup> As discussed in note 35, above, Company Act Rule 7d-1, although theoretically available to all Foreign Public Funds, historically demonstrates that the likelihood of reconciling all conflicts between the Company Act and foreign laws which may apply to Foreign Public Funds, such as bankruptcy laws, is highly unlikely.

<sup>45</sup> See *Mutual Fund Redemption Fees*, SEC Release No. IC-27504 (Sept. 27, 2006) [70 Fed. Reg. 13328 (March 18, 2005)] at 8. See also, *Mutual Fund Redemption Fees*, SEC Release No. IC-26782 (March 11, 2005) [71 Fed. Reg. 58257 (October 3, 2006)], requesting additional comments, in which the SEC acknowledged “the difficulty of applying fund market timing restrictions to shares redeemed through omnibus accounts” when originally adopting the shareholder information agreement component of Rule 22c-2. *Id.* at 18.

<sup>46</sup> See *Political Contributions by Certain Investment Advisers*, SEC Release No. IA-3043 (July 1, 2010) [75 Fed. Reg. 41018 (July 14, 2010)] (“We also understand that it is not uncommon for contributions of 403(b) and 457 plans to be commingled into an omnibus position that is forwarded to the fund, making it more challenging for an adviser to distinguish government entity investors from others.”) at n.375 and accompanying text.

<sup>47</sup> See Investment Company Institute, SEC No-Action Letter (Sept. 12, 2011).

more relevant under the Volcker Rule because it contains no statutory impediment like Company Act Section 7(d) which would force any Agency, including the SEC, to determine whether or not a foreign regulatory scheme is equivalent to the Company Act or to recognize any foreign regime as comparable. The only relevant inquiries under the Volcker Rule are whether Foreign Public Funds offered or sold to a handful of U.S. residents on the limited private placement basis long-recognized by the SEC would impact the financial integrity of the U.S. banking system or are, in fact, similar to private equity or hedge funds. As yet, neither Congress nor the Agencies have presented evidence that this activity has had or is expected to have any such effect or that Foreign Public Funds should be treated differently from US Public Funds.

Excepting Canadian Public Funds from the definition of “covered fund” would not risk bank safety and soundness, threaten U.S. financial stability or result in the inappropriate transfer of federal subsidies to unregulated entities, all of which are underlying policies of the Volcker Rule. The U.S. bank affiliates of the Canadian Banks have no financial exposure to the Canadian Funds nor would such funds be able to assert a claim to federal subsidies such as FDIC insurance.

More importantly, as discussed above, Canadian Public Funds are subject to their own statutory and regulatory regime designed to protect fund investors, maintain the safety of fund investments and protect the funds from conflicts of interest with their managers and affiliates. Moreover, because the vast majority of their investors are Canadian citizens and residents, they have little if any impact on U.S. financial markets except to the extent that they add liquidity to U.S. markets by buying U.S. securities or executing transactions through U.S. broker-dealers. Similar arguments should be applicable to all regulated Foreign Public Funds. Again, we are not asking the Agencies to determine the comparability of any foreign regulatory scheme to the Company Act. We ask only that the Agencies treat Canadian and other Foreign Public Funds the same as US Public Funds in the absence of convincing evidence that such funds threaten U.S. financial stability or should be viewed as similar to hedge funds or private equity funds.

## **II. Proposed U.S. Residency Standard Makes Foreign Fund Exemption Unworkable**

### Questions 293 and 295

In addition to seeking the explicit exclusion of Canadian Public Funds from the definition of “covered fund,” we are also seeking a more workable foreign fund exemption for all Foreign Funds. On its face, the Volcker Rule prohibits a foreign banking entity<sup>48</sup> from having an ownership interest in and/or sponsoring any Foreign Fund which “is offered for sale or sold to a resident of the United States.”<sup>49</sup> Because the Proposal incorporates into the foreign fund exemption a very broad definition of “resident of the United States,” the exemption applies only if all of a Foreign Fund’s transactions “occur solely outside the United States” *and* do not include any transactions with anyone deemed to be a “resident of the United States.”<sup>50</sup> The mere offer or sale of a Foreign Fund, whether public or private, to a U.S. resident investor under the limited circumstances previously recognized by the SEC should not result in the loss of the foreign fund

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<sup>48</sup> Both the statutory definition of “banking entity” and the Proposal’s revised definition would include any affiliated investment adviser. *See* definition of “Banking Entity” in note 16, above. The revised definition of “Banking entity” in the Proposal does not change this result. *See* Proposed Rule §\_\_2(e)(4).

<sup>49</sup> *See* Dodd-Frank, *supra* note 1, §619 (to be codified at BHCA §13(d)(1)(I) (12 U.S.C. 1851).

<sup>50</sup> Proposed Rule §\_.13(c)(1)(iii) and (iv).



exemption.<sup>51</sup> Simply put, it will be impossible for any Foreign Fund, public or private, to comply with the proposed conditions of the Proposal, in particular to determine or prevent the offer or sale of units to US residents.<sup>52</sup>

Once again, we note that the Proposal sought input on this issue. In particular, Question 293 inquired whether “the proposed rule’s provisions regarding when a transaction or activity will be considered to have occurred solely outside the United States [are] effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Should additional requirements be added? If so, what requirements and why? Should additional requirements be modified or removed? If so, what requirements and why or how?”<sup>53</sup> More importantly, Question 295, inquired, in pertinent part, whether “the proposed rule effectively define[s] a resident of the United States for these purposes? If not, how should the definition be altered?”<sup>54</sup>

As previously discussed in the context of Canadian or other Foreign Public Funds, Foreign Funds may enter into transactions with U.S. residents inadvertently as a result of omnibus accounts. In addition, Foreign Funds may enter into transactions with investors who are not U.S. citizens, but who are physically present in the U.S. on a temporary basis. For example, Canadian citizens, who generally also reside in Canada and are otherwise eligible fund unitholders, may request a purchase or sale transaction or seek information from a Canadian Fund while temporarily in the U.S., particularly persons who are traveling on business for prolonged periods of time, vacationing or “snowbirding” in seasonal residences. In an age of instant communications from smart phones, personal digital assistants and other web-enabled devices, it is nearly impossible for a fund manager, distributor or other fund service provider to determine whether a unitholder is communicating from a location within Canada, the United States or some other country.

Given the near impossibility of divining where any fund investor may be at the time a transaction or information request is made, it is unreasonable to assume that the phrase “resident of the United States” should be interpreted to sweep within its purview every truly non-U.S. person who just happens to be located on U.S. soil at the time of making a request for a fund transaction

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<sup>51</sup> For example, the SEC expressly excluded participants in foreign pension plans whose retirement assets are invested in a Foreign Fund from new rules implementing a Dodd-Frank exemption designed to determine whether a foreign adviser with clients or investors “in the United States” is exempt from SEC registration under the Advisers Act. *See SEC Exemptions Release, supra* note 40, at 39679 (stating, “based on the same policy considerations embodied in Rule 7d-2, we believe that a non-U.S. adviser should not be required to treat Participants as investors in the United States under rule 202(a)(30)-1 with respect to investments they make after moving to the United States if the fund is in compliance with rule 7d-2.”).

<sup>52</sup> We also note that the *de minimis* exemption set forth in Proposed Rule §.12(a)(1)(ii) only permits a banking entity to make or retain a 3 percent investment in a covered fund that it sponsors and operates. Moreover, the Proposal requires that a banking entity reduce its ownership interest in a fund to less than 3 percent of the total ownership interests within one year of the fund’s establishment (Proposed Rule §.12(a)(2)(i)(B)) or seek approval from the Federal Reserve for an extension for up to two years. This extension process is unwieldy and does not comport with the market reality that institutional investors generally require a minimum three-year performance history before considering investment in a fund. As a result, start-up funds must generally maintain seed capital for a period of three years or more. Neither attempting to rush the investment process nor requiring applications for exemptive relief will have any meaningful impact on promoting safety and soundness in the banking system. We recommend extending the seed capital period to three years.

<sup>53</sup> Proposal, *supra* note 2, at 688911-12.

<sup>54</sup> *Id.* at 68912.

or fund information. This phrase should not be so broadly interpreted as to activate the divestiture requirements of the Volcker Rule simply because a foreign banking entity with an ownership or sponsorship interest in a foreign fund accepts purchase or sale orders from non-U.S. persons who happen to be temporarily present in the U.S. At a minimum, the Proposal should be clarified to exclude such a result, but other options are available.<sup>55</sup>

Absent narrowing the proposed definition of “resident of the United States,” the foreign fund exemption would be unavailable to every Foreign Fund which relies on interpretive relief previously provided by the SEC or its Staff to exclude certain persons from the definition of U.S. Persons because such persons are not excluded under the Proposal.<sup>56</sup> The Canadian Banks strongly urge the Agencies to apply the regulatory framework created by the SEC and its Staff to allow the foreign fund exemption to protect transactions involving non-U.S. persons who were fully eligible to invest in their funds prior to being deemed a U.S. resident and wish to maintain and manage such investments afterwards.<sup>57</sup>

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<sup>55</sup> For example, in the *IFIC Letter*, the SEC Staff imposed several conditions for determining that a foreign fund is not making a public offering to U.S. persons, including prohibiting the fund and its agents or affiliates from engaging in activities that could reasonably be expected or intended to condition the U.S. market with respect to the fund’s securities (e.g., advertising in a U.S. publication, or facilitating secondary market trading in the United States with respect to the fund’s securities). As long as these conditions are met, certain U.S. persons may be treated as a “Non-U.S. Holder,” including: (i) a U.S. resident beneficial owner who was not a U.S. resident when purchasing the securities of the Non-U.S. Fund; (ii) any subsequent U.S. resident transferee of such securities; or (iii) a U.S. resident beneficial owner who purchased the securities of the foreign fund in an offshore secondary market transaction not involving the foreign fund or its agents, affiliates or intermediaries. Foreign Funds meeting the conditions may continue to use U.S. jurisdictional means to provide certain services to U.S. investors, including: (a) the mailing of securityholder reports, account statements, proxy statements and other materials that are required to be provided by foreign law and the fund’s governing documents; (b) the processing of redemption requests and payment of dividends and distributions; (c) the mechanical processing of transfers of ownership; and (d) the issuance of securities pursuant to a dividend reinvestment plan. *IFIC Letter*, *supra* note 37. Persons meeting the definition of “Non-U.S. Holder” should be excluded from the proposed definition of “resident of the United States.”

<sup>56</sup> “Resident of the United States” is defined in Proposed Rule §\_2(t). Nothing in this definition takes into account exceptions to transactions occurring within the United States which have been previously recognized by the SEC. In adopting rules to implement the foreign private adviser exemption from SEC adviser registration created by Dodd-Frank, the SEC expressly excluded from the definition of “in the United States” any investor in a private fund who was not in the United States each time the investor acquired securities issued by the fund. See *SEC Exemptions Release*, *supra* note 40, at 39678. In addition, the SEC acknowledged and adopted prior relief granted to the Canadian Fund industry to allow “non-U.S. advisers not to count persons (and their assets) who invest in a foreign private fund through certain Canadian retirement accounts (“Participants”) after having moved to the United States” for purposes of determining whether they would qualify for the foreign private adviser exemption. *Id.* at 39679.

<sup>57</sup> We note that the SEC has defined the term “U.S. Person” for purposes of Regulation S (“Reg. S”), which governs offers and sales made outside the United States without registration under the Securities Act of 1933. See Regulation S, § 902(k), 17 C.F.R. §230.902(k). While Reg. S defines “U.S. Person” broadly, it also contains a number of specific exclusions. For example, Reg. S excludes an “employee benefit plan established and administered in accordance with the law of a country other than the United States and customary practices and documentation of such country.” *Id.* at Subsection 902(k)(2)(iv). More importantly, the SEC Staff previously concluded that a foreign fund “generally may rely on the definition of ‘U.S. person’ in Rule 902(k) of Reg. S . . . in determining whether a potential investor must be counted or qualified for purposes of complying with Section 3(c)(1) or 3(c)(7) of the Company Act.” See *Goodwin II*, *supra* note 40, above.

### III. Scope of the Term “Affiliate”

#### Questions 6, 7 and 8

As previously noted, the Volcker Rule’s definition of “banking entity,” which includes every “affiliate” of a banking entity, is extremely broad.<sup>58</sup> Under the statutory text, if a fund of any kind, foreign or domestic, private or public, including US Public Funds, were deemed to be controlled by or under common control with such a bank, it would then be prohibited under subsection (a)(1)(A) of the Volcker Rule from engaging in “proprietary trading,” or trading for its own portfolio or investing in or sponsoring covered funds, unless the activities were permissible under another provision of the Volcker Rule.

The Proposal clearly acknowledges that the overly broad statutory definition of “banking entity” would, if left unchanged, create unintended consequences such as preventing covered funds from investing in other covered funds.<sup>59</sup> In an effort to address this unintended result, the Proposal offers a revised definition of “banking entity” which would exclude any “covered fund that is organized, offered or held by a banking entity pursuant to Section \_\_.11 and in accordance with the provisions of subpart C [Covered Fund Activities and Investments]” or any “entity that is controlled by [such] a covered fund.”<sup>60</sup>

However, this exclusion is insufficient to address the unintended consequences recognized by the Proposal. By excluding only a small subset of permissible covered funds, the Proposal fails to exempt from the Volcker Rule’s prohibitions other permissible funds that could be deemed affiliates. First, the exclusion, by its terms, is ambiguous in the scope of the covered funds intended to be captured. It states that covered funds would be excluded if organized, offered or held by a banking entity pursuant to Section \_\_.11 and in accordance with subpart C. Sections of subpart C other than Section \_\_.11 authorize banking entities to organize, offer or hold covered funds, including Section \_\_.13(a) (“Permitted investments in SBICs and related investments”) and, of particular importance to the Canadian Banks, Section \_\_.13(c) (“Covered fund and investment activities outside of the United States”). In discussing this exclusion, the Proposal makes no attempt to distinguish between types of covered funds. In addition, the Proposal seeks no comment on whether the exclusion should extend to covered funds organized by foreign banking entities or to SBIC funds, rather than covered funds organized under Section \_\_.11. Given that the unintended consequences of the prohibitions on proprietary trading or fund

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<sup>58</sup> See *supra* note 16. While Dodd-Frank does not define the term “affiliate” for purposes of the Volcker Rule, the definition of this term in Section 2 of the BHCA would include every company controlled by or under common control with a U.S. bank or with a foreign bank that has a U.S. branch or agency. Proposed rule §§1.2(a) and (bb) incorporate the BHCA’s definitions of “affiliate” and “subsidiary” with the explanation that “the proposed rule implements section 13 of the [BHCA].” Proposal, *supra* note 2, at 68854.

<sup>59</sup> In proposing a revised version of the Dodd-Frank definition of “banking entity,” the Agencies purported in the Preamble to excluded from the term “any affiliate or subsidiary of a banking entity, if that affiliate or subsidiary is (i) a covered fund, or (ii) any entity controlled by such a covered fund.” *Id.* at 68855. See also Proposed Rule §\_\_.2(e)(4). However, as discussed below, not all covered funds were in fact excluded and the regulation should be amended to meet the apparent intent in the Preamble. The Preamble explained that the proposed change is necessary to prevent a covered fund itself from becoming “subject to all of the restrictions and limitations of section 13 of the BHCA and the proposed rule, which would be inconsistent with the purpose and intent of the statute. For example, such a covered fund would then generally be prohibited from investing in other covered funds, notwithstanding the fact that section 13(f)(3) of the BHCA specifically contemplates such investments.” *Id.* at 68856.

<sup>60</sup> Proposed Rule §\_\_.2(e)(4).

investment are just as serious for an SBIC fund or foreign covered fund as for a domestic covered fund, we do not believe there is any basis, nor does the Proposal offer any, for not clearly extending the exclusion to all subpart C covered funds. This ambiguity could be readily addressed by deleting the reference to Section \_\_.11 in the exclusion.

Second, the exclusion fails to capture funds that rely on exemptions other than those set forth in Company Act Sections 3(c)(1) and 3(c)(7). Thus, funds that are not covered funds could be prohibited from trading for their own portfolios even when securities need to be liquidated or otherwise disposed of in the ordinary course of business. This appears to be an even stranger unintended consequence. Surely the Volcker Rule was not intended to prevent every fund connected with a banking entity through permissible sponsorship or other ownership interest from purchasing and selling securities for its own portfolio in ways that might be deemed to be “proprietary trading.” Nor should the Volcker Rule be interpreted to have such a broad extraterritorial effect on Foreign Funds.

The Proposal sought comment on whether the term “affiliate” is too broadly defined and whether some funds should be excluded. Specifically, Question 6 inquired whether any entities “should not be included within the definition of banking entity because 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?”<sup>61</sup> Similarly, Question 8 noted that “[b]anking 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” and then asked whether “a registered investment company [should] be expressly excluded from the definition of banking entity?”<sup>62</sup>

We submit that US Public Funds, *i.e.*, registered investment companies, should be expressly excluded from the definition of affiliate to maintain consistency with the statutory exclusion of registered funds from the definition of “hedge fund” or “private equity fund” or the Proposal’s definition of “covered fund” and, for the reasons set forth above, Canadian and other Foreign Public Funds should be treated in the same way. There is no policy rationale for even implying that such funds should be subject to the Volcker Rule’s limitation on proprietary trading when, in the case of US Public Funds, they are not covered funds in the first place and, in the case of Canadian and other Foreign Public Funds, should not be deemed to be covered funds based on their inherent similarities with US Public Funds.<sup>63</sup>

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<sup>61</sup> Proposal, *supra* note 2, at 68856.

<sup>62</sup> *Id.*

<sup>63</sup> We also note that banking entities often use special purpose entities (“SPEs”) and other vehicles as intermediary companies for various tax, liability and other business reasons to hold interests in funds. Frequently these entities rely on Company Act Section 3(c)(1). We submit that these SPEs and other vehicles should not be treated as covered funds to the extent they are investing in loan securitization vehicles or other funds that are not subject to the Volcker Rule prohibition on sponsorship of or ownership in covered funds. Thus, banking entities should be permitted to invest or sponsor such SPEs or similar intermediary corporate vehicles.

Accordingly, we submit that “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” is not adequate.<sup>64</sup> The definition of “banking entity” should be modified to exclude all permitted funds, including funds that rely on Company Act exemptions other than 3(c)(1) or 3(c)(7), funds that are excluded from the definition of covered fund (e.g., as we recommend be the case for Canadian and other Foreign Public Funds) and covered funds that are exempt under subpart C, at least for purposes of allowing any such funds to trade for their own account or investing in covered funds.


### Conclusion

For all of the foregoing reasons, we respectfully request that the Agencies: (i) explicitly exclude from the definition of “covered fund” all Canadian and other Foreign Public Funds; (ii) expressly permit all Foreign Funds to exclude from the term “resident of the United States” certain omnibus accounts and *non-U.S. persons* who are temporarily present or resident in the U.S., but otherwise eligible to invest in Foreign Funds, for purposes of the foreign fund exemption; and (iii) narrowly interpret the term “affiliate” as used in the term “banking entity” to ensure that no fund is prohibited from engaging in trading for its own account or investing in covered funds.

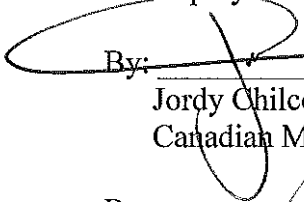
Should you have any questions about this submission, please contact Elizabeth M. Knoblock, 202-263-3263, at Mayer Brown LLP.

Respectfully submitted on the above-referenced date, on behalf of:

Bank of Montreal

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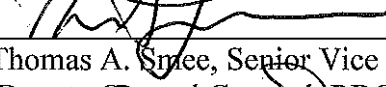
The Bank of Nova Scotia

By:   
Jordy Chilcott, Head  
Canadian Mutual Funds

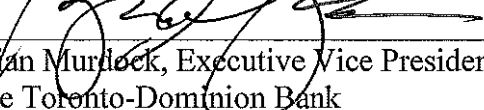
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<sup>64</sup> See Proposal, *supra* note 2, at 68856 (Question 7).