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Re: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, FRB Docket No. R-1432 / RIN 7100 AD 82, FDIC RIN 3064-AD85, SEC File No. S7-41-11 / RIN 3235-AL07, OCC Docket No. OCC–2011–0014 / RIN 1557-AD44, CFTC RIN No. 3038-AC[•]

Wells Fargo & Company ("**Wells Fargo**") appreciates the opportunity to comment on the Notice of Proposed Rulemaking (the "**NPR**") jointly issued by the Board of Governors of the Federal Reserve System ("**Board**"), the Securities and Exchange Commission ("**SEC**"), the Federal Deposit Insurance Corporation ("**FDIC**") and the Office of the Comptroller of the Currency ("**OCC**") (collectively, the "**Agencies**"), implementing new Section 13 of the Bank Holding Company Act of 1956, as amended (the "**BHC Act**"), the so-called "**Volcker Rule,**" as set forth in Section 619 of the Dodd-Frank Wall Street Reform and Protection Act (the "**Dodd-Frank Act**").

Wells Fargo expresses its strong support for comment letters filed by certain trade associations of which it is a member ("**Trade Group Letters**") urging that, consistent with the terms, purposes, and legislative history of the Volcker Rule, the Agencies should define the term "covered fund" in a way that does not capture ordinary course corporate structures, such as wholly owned subsidiaries. These types of structures have never been considered "hedge funds" or "private equity funds" as those terms are commonly understood, nor are they pooled investment vehicles.

The unintended negative impacts arising from the failure of the NPR to exclude these types of corporate structures from the definition of "covered fund" is discussed extensively in Trade Group Letters. This comment letter, however, focuses primarily on one important issue and specific corporate structure used by Wells Fargo: we believe that for purposes of the requested revision to the "covered fund" definition, investment subsidiaries of a banking entity in which its "knowledgeable employees" own a *de minimis* interest, but the securities of which are otherwise wholly owned by the banking entity, should be treated the same as wholly-owned subsidiaries. To distinguish such subsidiaries from wholly owned subsidiaries would result in the inadvertent and inappropriate categorization, as a "private equity fund", of a subsidiary investment structure that Wells Fargo has long used to make permissible direct merchant banking and venture capital investments in operating companies and that we believe decreases risk by aligning the interests of a banking entity with the employees who manage its investments and that bears no more resemblance to a private equity or hedge fund than a wholly-owned subsidiary.

WELLS FARGO

Wells Fargo is a diversified financial services company, providing retail, commercial and corporate banking services through banking stores located in 39 states and the District of Columbia. Wells Fargo provides other financial services through subsidiaries engaged in various businesses, principally: wholesale banking, mortgage banking, consumer finance, equipment leasing, agricultural finance, commercial finance, securities brokerage and investment banking, insurance agency and brokerage services, computer and data processing services, trust services, investment advisory services, mortgage-backed securities servicing and merchant banking and venture capital investment.

Wells Fargo currently engages in merchant banking and venture capital activities through various business lines, primarily through its Wholesale Banking Group and through its Norwest Equity Partners ("**NEP**") and Norwest Venture Partners ("**NVP**") affiliates. In addition to the equity investments we make in operating companies directly, Wells Fargo also makes permissible merchant banking investments utilizing various corporate structures such as joint ventures, wholly owned subsidiaries, and side car funds. Principally through its NEP and NVP business lines, Wells Fargo makes merchant banking and venture investments utilizing a subsidiary structure in which virtually all (99%) of the securities (debt as well as equity) are owned by Wells Fargo, with the remaining 1% principally owned by certain knowledgeable employees involved in the investment activities of the subsidiary (the "**Wells Fargo Investment Structure**"). For the reasons set forth in this comment letter, Wells Fargo believes the Wells Fargo Investment Structure should be excluded from the definition of "covered funds."

RELATIONSHIP OF THIS LETTER TO OTHER COMMENT LETTERS IN WHICH WELLS FARGO HAS PARTICIPATED

Wells Fargo is submitting a separate comment letter on the Volcker Rule, focused on the NPR's proposed ban on proprietary trading and matters related to certain fund aspects of the Volcker Rule. As described in that letter, Wells Fargo also has participated in the preparation of comment letters on the Volcker Rule to be submitted to the Agencies by various trade groups. This comment letter is not a comprehensive response to each of the Agencies' requests for comments on the NPR, for which Wells Fargo is primarily relying on the Trade Group Letters. Instead this comment letter, along with Wells Fargo's comment letter on proprietary trading and certain fund matters, is intended to emphasize impacts of significance to Wells Fargo that are not fully addressed in the Trade Group Letters.

Wells Fargo wishes to stress, however, its agreement with and endorsement of the analysis and proposals contained in the Trade Group Letters as they relate to the failure of the NPR to exclude from the definition of "covered funds" certain corporate structures, such as wholly owned subsidiaries, that do not constitute pooled investment vehicles or private equity funds as commonly understood and which do not engage in the type and scope of activities to which Congress intended the Volcker Rule to apply. Wells Fargo also agrees with the Trade Group Letters' analysis of (i) the impact from a compliance and cost/benefit steadpoint on the financial industry of a failure to implement the recommendation to exclude such structures from the definition of "covered fund" and (ii) the authority of the Agencies to implement these modifications in the final rules under Dodd Frank. Consequently, these arguments, positions and recommendations will not be repeated in this comment letter except as may be appropriate for context or narrative flow.

ANALYSIS

Covered Fund Definition

The NPR recognizes that "the definition of 'covered fund' . . . potentially includes within its scope many entities and corporate structures that would not usually be thought of as a 'hedge fund' or 'private equity fund.'"[1] For this reason, the Financial Stability Oversight Council ("**FSOC**") had recommended that the Agencies "carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the "**'40 Act**") and consider whether it is appropriate to narrow the statutory definition by rule in some cases."[2] Consequently, to reflect Congressional intent, the Agencies proposed a number of exemptions from the Volcker Rule's prohibitions for certain

1 *Notice of Proposed Rulemaking: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds*, 76 Fed. Reg. 68846, 68897 (Nov. 7, 2011) ("**NPR**").

2 Financial Stability Oversight Council, *Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds*, at 62 (Jan. 2011).

entities that would otherwise qualify as a private equity fund or hedge fund (*i.e.*, a "covered fund"), but "which do not engage in the type and scope of activities to which Congress intended section 13 of the BHC Act to apply."[3] The Agencies also asked in the NPR whether other entities are inappropriately included in the proposed definition of "covered fund" and whether that definition should focus on the characteristics of an entity rather than its reliance on Section 3(c)(1) or 3(c)(7) of the '40 Act.[4]

The Wells Fargo Investment Structure represents a clear and compelling example of another type of corporate structure or vehicle that does not engage in the activities to which Congress intended the Volcker Rule to apply, yet which would be prohibited under the definition of "covered fund" in the NPR. Accordingly, consistent with the legislative intent of the Volcker Rule and sound public policy, Wells Fargo submits that the definition of "covered fund" in Proposed Section __.10 (b)(1) should exclude any subsidiary of a banking entity, all the securities of which are owned by the banking entity and its knowledgeable employees (*e.g.*, investment professionals), provided that such employees own less than 5% of the securities of the subsidiary.[5] This would permit a banking entity to continue to engage in permissible activities (including permissible merchant banking and venture capital activities) through its wholly owned subsidiaries, and through its subsidiaries that are otherwise wholly owned, but in which a limited number of investment professional employees co-invest to provide them with "skin in the game."

This clarification of the coverage of the Volcker Rule would not only be consistent with the terms, purposes, and legislative history of the Volcker Rule,[6] but it would also serve the

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3 NPR, 76 Fed. Reg. at 68913.

4 *Id.*, Questions 217, 221 and 225, 76 Fed. Reg. at 68898-99.

5 We believe our proposal is consistent with the Trade Group Letters' proposed exclusion of wholly owned subsidiaries from the definition of "covered fund," although we note the Trade Letters do not directly address the issue of a *de minimis* amount of securities owned by knowledgeable employees. In substance, Wells Fargo's suggested approach is that a subsidiary that is wholly owned except for *de minimis* investments by knowledgeable employees should be considered a wholly owned subsidiary. The most important point here is that the subsidiary does not have any <u>outside</u> investors.

6 Wells Fargo believes that the Agencies have the authority under subsections (b) and (h)(2) of Section 13 of the BHC Act to determine by rule which entities that rely on Sections 3(c)(1) or 3(c)(7) of the '40 Act are "covered funds" for the purposes of the Volcker Rule. This interpretation would be consistent not only with the FSOC's recommendation that the Agencies narrow the definition of "private equity fund" and "hedge fund," but also with the legislative history of the Volcker Rule, indicating that not all entities that rely on Sections 3(c)(1) or 3(c)(7) of the '40 Act would be covered by those definitions. As described below, Representative Frank, for whom the public law containing the Volcker Rule is named, emphasized that this distinction between private equity funds and hedge funds (on the one hand) and normal investment structures (on the other) is provided for in the statute itself and should be maintained by the Agencies. *See* 156 Cong. Rec. H5226 (daily ed. June 30, 2010) (statement of Rep. Frank).

important public policy goal of ensuring that the permissible activities of banking organizations and their subsidiaries are conducted in a safe and sound manner. The types of subsidiaries utilized by Wells Fargo through the Wells Fargo Investment Structure are simply vehicles through which Wells Fargo conducts permissible activities; they are not normally thought of, nor do they operate as, private equity funds or hedge funds. The defining characteristic of private equity funds and hedge funds is that they serve as collective investment vehicles. The Wells Fargo subsidiaries utilized in the Wells Fargo Investment Structure would not in any respect operate as such, as none of their securities would be issued to persons other than to Wells Fargo and a limited number of knowledgeable employees.

In fact, in a no-action letter, the SEC staff has recognized the lack of any public interest in regulating such a subsidiary structure (in which all the securities of the subsidiary are held by the parent and knowledgeable employees) under the '40 Act.[7] Under this no-action position, such a subsidiary would not need to rely on an exemption from the definition of "investment company" provided by Section 3(c)(1) or 3(c)(7) of the '40 Act; and, therefore, it would not be a private equity fund or hedge fund under the Volcker Rule's definition. To provide legal certainty and transparency in this important area, this position should be reflected in the regulations implementing the definition of "covered fund" for purposes of the Volcker Rule.[8]

This clarification of the coverage of the Volcker Rule would be consistent with Congressional intent for several additional reasons. First, this type of subsidiary structure does not present the "bail out" risk at which is the Volcker Rule is aimed[9] because there are no outside investors to be bailed out, and the assets and liabilities of these subsidiaries are fully reflected on the books of the banking entity. Second, a banking entity could not use this structure to avoid the Volcker Rule's prohibitions, because any subsidiary covered by this clarification would itself be a "banking entity" and therefore would be subject to the prohibitions on proprietary trading and investing in private equity funds or hedge funds. Third, this

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7 *Continental Illinois Limited*, SEC Staff No-Action Letter (avail. Apr. 1, 1973), interpreting the scope of the exemption of Section 3(b)(3) of the '40 Act.

8 Section 3(b)(3) of the '40 Act, on which the SEC staff's *Continental Illinois* no-action letter is based, provides that a company is not an "investment company" if all of its outstanding securities (other than short-term paper and directors' qualifying shares) are directly or indirectly owned by a parent company that is excepted from the definition of "investment company" by Section 3(b)(1) or 3(b)(2) of the '40 Act. In order for Section 3(b)(3) to apply to a wholly owned subsidiary of a bank holding company, a no-action or other interpretative position of the SEC or its staff is necessary, because typically a bank holding company is *not* an investment company (or, alternatively, is excepted from the definition of investment company by Section 3(c)(6) of the '40 Act) and therefore does not need to find an exception from the definition of investment company within Section 3(b). In addition, the Wells Fargo structure differs somewhat, we believe immaterially, from the structure that was the subject of the no-action letter.

9 156 Cong. Rec. S5895 (daily ed. July 15, 2010) (statement of Sen. Merkley).

clarification would be in accordance with the intent of Congress, as evidenced by explicit legislative history, not to interfere with how a banking entity may structure its permissible investment holdings. The Volcker Rule was not intended and should not be applied to prohibit a banking entity from conducting activities through a subsidiary that it could otherwise conduct directly.

Finally, our proposed clarification would promote safety and soundness, as this type of subsidiary investment structure has long been recognized by Congress, the Board and the SEC as important for managing risk and aligning incentives. Indeed, this co-investment structure is explicitly permitted in the asset management exemption of the Volcker Rule itself.[10] The use of this structure not only insulates the holding company from liability from investment activities through the protection afforded by a separate legal entity, but it also controls risk-taking by investment professional employees by providing them with "skin in the game." Consequently, interpreting the Volcker Rule to prohibit such a structure would deprive banking entities of an important and common risk management technique and potentially introduce additional risk into the banking system.

Overview of Wells Fargo Investment Structure

As noted above, like many financial holding companies, Wells Fargo makes merchant banking and venture capital investments that are permissible under the BHC Act. These types of merchant banking and venture capital investments were authorized by the Gramm-Leach-Bliley Act, and the ability of financial holding companies to continue to make these investments was not prohibited by the Dodd-Frank Act or the Volcker Rule, provided that the investments do not constitute proprietary trading or involve investments in private equity funds or hedge funds.

Wells Fargo's investments through its Wells Fargo Investment Structure do not involve proprietary trading or investments in private equity funds or hedge funds; rather, investments are made directly by Wells Fargo in established or start-up operating companies. Importantly, these investments are not funded by outside investors.

In accordance with sound risk management practices encouraged by the Board, Wells Fargo generally makes these direct investments through special purpose limited partnership subsidiaries. Approximately 99% of the partnership interests in the Wells Fargo Investment Structure subsidiaries (in the form of limited partnership interests) are owned by a direct subsidiary of Wells Fargo. The remaining partnership interests in the subsidiaries (in the form of the general partnership interest and some limited partnership interests) generally are owned by individuals that are, or were at the time of the investment, investment professional employees of Wells Fargo ("**Wells Fargo Employees**").[11] Consistent with industry practice, the ownership of

10 New Section 13(d)(1)(G)(vii) of the BHC Act, 12 U.S.C. § 1851(d)(1)(G)(vii).

11 Currently, a small amount of limited partnership interests in one or more of the Wells Fargo NEP and NVP subsidiaries are owned by employees' family members and a few consultants to the subsidiaries; however, Wells Fargo contemplates repurchasing or redeeming any securities held by these persons. Wells Fargo is not seeking a clarification

interests in each partnership subsidiary by the Wells employees is designed to align their incentives with that of Wells Fargo.

In the absence of another clear exception from the definition of "**Investment Company**" under the '40 Act, as a result of the allocation of ownership interests to Wells Fargo Employees, these investment subsidiaries of Wells Fargo generally would meet the technical definition of an "investment company," but for the exemption from registration provided by Section 3(c)(1) or 3(c)(7) of the '40 Act. As a result, they would also technically fall under the Volcker Rule's broad definition of "private equity fund," notwithstanding the fact that, unlike the typical private equity fund or hedge fund, no capital for the subsidiaries would be sourced from outside investors, no equity securities would be issued to anyone other than Wells Fargo and a limited number of knowledgeable Wells Fargo Employees, and no other securities (including debt securities) would be issued to anyone other than Wells Fargo.

The Wells Fargo Investment Structure, Which Permits De Minimis Investments by Knowledgeable Employees, Should Not Be Barred by the Volcker Rule

- ***As No Securities Would Be Issued to Outside Investors, the Wells Fargo Investment Subsidiaries Are not the Types of "Funds" the Volcker Rule Was Intended to or Should Cover.***

Because no funds would be raised for the Wells Fargo investment subsidiaries in question from persons other than Wells Fargo and the Wells Fargo Employees, these subsidiaries should not be "private equity funds" or "hedge funds" as those terms are used in the Volcker Rule. These internal vehicles used by Wells Fargo to make permissible investments are not "funds" in any normal or accepted sense of that term. The defining characteristic of private equity funds and hedge funds is that they are collective investment vehicles. By no means are the Wells Fargo NEP/NVP subsidiaries collective investment vehicles, as they will not pool money from outside investors. As noted above, the SEC staff has indicated agreement in a no-action position that a similar type of internal subsidiary investment structure could rely on the exemption under Section 3(b)(3) of the '40 Act; therefore, by implication, such structures would not need to rely on an exemption under Section 3(c)(1) or 3(c)(7) of the '40 Act.[12] This no-action letter concluded that the Section 3(b)(3) exemption (generally available to a certain entities all the securities of which are owned by the parent company) would not be lost because some of the entity's securities were held by knowledgeable employees. The SEC staff reasoned that because the employee investors were in management positions and had intimate knowledge of the subsidiary's financial and business status, assertion of jurisdiction under the '40 Act was unnecessary.

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of the coverage of the Volcker Rule that would permit co-investment by persons other than Wells Fargo employees actively involved in the activities of the subsidiaries.

12 *Continental Illinois Limited, supra* note 7. As also noted previously, it is not currently clear that a wholly owned subsidiary of a bank holding company could rely on the exemption contained in Section 3(b)(3) of the '40 Act.

- ***The Proposed Exemption Is Consistent with the Purposes of the Volcker Rule and with the Clear Intent of Congress Not to Interfere with How Banking Entities Structure Their "Normal" Investment Holdings.***

Senator Merkley, who was one of the Senators most engaged in developing the Volcker Rule, explained that the ban on investments in covered funds had two principal purposes. These were (i) to eliminate the ability of banking entities to conduct proprietary trading through such funds, and (ii) to avoid the possibility that a banking entity that sponsors or manages a fund will feel compelled by reputational demands to "bail out" clients in a failed or troubled fund, thereby exposing the bank to additional risk.[13] Neither of these concerns is implicated by permitting banking entities to conduct permissible activities through subsidiary investment vehicles, all the securities of which are owned by the banking entity and its investment professional employees.

As to the first concern cited by Senator Merkley, ***these investment subsidiaries are also covered banking entities*** and are thus directly subject to the proprietary trading and covered fund investment prohibitions of the Volcker Rule. In point of fact, the investments made by the Wells Fargo's investment subsidiaries do not constitute proprietary trading, as they generally are long-term (*e.g.*, 4-7 year) investments and do not involve the use of a trading account and Wells Fargo does not typically, and will not, invest in any private equity funds or hedge funds through these subsidiaries. As to the second concern, as noted above, "bail out" risk is not present in these investment structures, since no outside clients (or other third parties) invest in the Wells Fargo subsidiaries and the risk of the assets held by these subsidiaries is fully reflected on the Wells Fargo balance sheet and properly supported by capital charges. These subsidiaries currently are and, under the Volcker Rule, as 'banking entities" will continue to be fully subject to supervision and examination by the Board, eliminating the risk of evasion.

The legislative history of the Volcker Rule confirms that Congress did not intend the Rule to inhibit the use of corporate structures, such as the Wells Fargo's Investment Structure, to hold permissible investments that could be made directly. In a colloquy referenced in the NPR,[14] Representative Himes asked Representative Frank to "confirm that when firms own or control subsidiaries or joint ventures that are used to hold other investments, the Volcker Rule won't deem those things to be private equity or hedge funds and disrupt the way the firms structure their normal investment holdings."[15] Representative Frank responded that "[t]he point [Representative Himes] makes is absolutely correct. . . . And the distinction [Representative Himes] draws is very much in this bill, and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure they do."[16]

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13 Statement of Sen. Merkley, *supra* note 9.

14 NPR, 76 Fed. Reg. at 68913, n. 320.

15 156 Cong. Rec. H5226 (daily ed. June 30, 2010) (statement of Reps. Himes and Frank).

16 *Id.*

Similarly, the colloquy between Senators Boxer and Dodd emphasizes the importance of preserving the ability of banking entities to provide venture capital to U.S. start-up companies. In response to Senator Boxer's stated belief that "the intent of the rule is not to harm venture capital investment," Senator Dodd confirmed that "properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J)."[17]

These colloquies unequivocally demonstrate that the Volcker Rule was not intended to prohibit a banking entity from owning an interest in a subsidiary used to "structure [its] normal investment holdings" or restrict venture capital. The activities conducted by the Wells Fargo subsidiaries are "normal," permissible investment activities, and, as described below, the structure of the Wells Fargo subsidiaries promotes safety and soundness, as recognized by Congress, the Board, and the SEC.

- ***Utilizing Subsidiaries for Direct Investments Limits Liability to Wells Fargo and Promotes Safety and Soundness.***

The Volcker Rule should not operate to prevent Wells Fargo from making through a subsidiary investments that it is authorized by law to make directly. In fact, utilizing such a subsidiary promotes safety and soundness. The Board has long encouraged bank holding companies to make permissible investments through subsidiaries in order to limit liability to the parent holding company:

> "In addition to limiting and monitoring exposure to portfolio companies that arises from traditional banking transactions, BHCs should also adopt policies and practices that limit the legal liability of the BHC and its affiliates to the financial obligations and liabilities of portfolio companies. *These policies and practices include, for example, the use of limited liability corporations or special purpose vehicles to hold certain types of investments, the insertion of corporations that insulate liability between the BHC and a partnership controlled by the BHC, and contractual limits on liability.*"[18]

Restricting the ability of a banking entity to utilize a subsidiary in making permissible investments would remove a valuable risk management technique and could increase the risk to the banking entity for obligations incurred by investee entities, significantly detracting from

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17 156 Cong. Rec. S5904-05 (daily ed. July 15, 2010) (statements of Sens. Boxer and Dodd).

18 Board of Governors of the Federal Reserve System, *Supervision and Regulation Letter 00-9*, *available at* http://www.federalreserve.gov/boarddocs/srletters/2000/SR0009.htm (emphasis added).

safety and soundness.

- ***Employee Financial Participation in a Banking Entity's Investment Vehicle Subsidiary Also Promotes Safety and Soundness and Should Not Cause That Subsidiary to Be Deemed a "Private Equity Fund."***

Congress and Federal agencies have repeatedly recognized – including in the context of the Volcker Rule itself – that employee co-investment structures are important to align the incentives of investment professionals with the goals of their employer organizations, thereby promoting safety and soundness in the banking system. Accordingly, legislative and regulatory actions have clarified in the past that such co-investment structures should not disqualify an investment entity from exemptive relief under a number of statutory provisions, a summary of which is provided below. For the same reasons, such co-investment structures should not cause a banking entity's investment vehicle subsidiary to be prohibited as a "private equity fund" under the Volcker Rule.

- ***Asset Management Exemption From the Volcker Rule***

Generally, for a banking entity to qualify for the asset management exemption to the Volcker Rule's prohibitions provided by new Section 13(d)(1)(G) of the BHC Act, no director or employee of the banking entity may hold an ownership interest in a sponsored hedge fund or private equity fund. Congress specifically carved out, however, from this general limitation ownership interests in a sponsored fund held by the banking entity's *directors and employees* who are "directly engaged in providing investment advisory or other services" to the fund.[19]

This exception, which is reflected in the NPR, recognizes that the ownership by such banking entity directors and employees of interests in sponsored funds is important to align incentives, and that such ownership does not implicate the concerns that the Volcker Rule was intended to address. As the Agencies recognized in the NPR, this co-investment structure "aligns the manager or adviser's incentives with those of its customers by allowing the individual to have 'skin in the game' . . . (which customers or clients often request)."[20]

- ***Board Supervision and Regulation Letter 00-9***

The Board's supervisory merchant banking guidance expressly recognizes the importance of co-investment structures with respect to a banking entity's direct merchant banking investments, stating that "these co-investment arrangements can be an important incentive mechanism and risk control technique and can help to attract and retain qualified management." [21]

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19 New Section 13(d)(1)(G)(vii) of the BHC Act, 12 U.S.C. § 1851(d)(1)(G)(vii).

20 NPR, 76 Fed. Reg. at 69802.

21 Supervision and Regulation Letter 00-9, *supra* note 18.

- **Sections 3(c)(1) and 3(c)(7) of the '40 Act**

In the National Securities Markets Improvement Act of 1996, Congress recognized that investments by "knowledgeable employees" of the issuer or an affiliated person should not cause the issuer to lose the exemptions under Sections 3(c)(1) and 3(c)(7) of the '40 Act, as such knowledgeable employees did not need the protections of the '40 Act.[22]
Under the SEC's implementing Rule 3c-5, a "knowledgeable employee" generally includes any executive officer, director, trustee, general partner, advisory board member, and, subject to certain restrictions, any investment professional employee.[23] As described below, we would recommend adopting a similar approach here, such that a covered fund would not include a company all the outstanding securities of which (debt as well as equity securities) are owned by a banking entity and, in limited amount, its "knowledgeable employees."

As the examples above illustrate, employee participation in a banking entity's permissible investments is important for the purposes of incentive alignment ("skin in the game"). This risk management objective should not be subverted by a rule under which an investment subsidiary is deemed to be a "private equity fund" solely due to financial participation by a limited number of knowledgeable employees.

PROPOSED ACCOMMODATION FOR EMPLOYEE CO-INVESTMENT STRUCTURES IN THE FINAL RULE

For the reasons set forth in this letter, Wells Fargo believes that the Wells Fargo Investment Structure it utilizes to conduct its merchant banking and venture capital investments should not be barred by the Volcker Rule. Accordingly, Wells Fargo submits that (i) the definition of "covered fund" in Proposed Section __.10(b)(1) should exclude

> *"Any company all the outstanding securities of which are directly or indirectly owned or controlled by a covered banking entity and its knowledgeable employees, provided that such knowledgeable employees own or control less than 5 percent of the company's outstanding securities."*

and (ii) "Knowledgeable employee" should be defined by largely mirroring the language of Rule 3c-5 of the '40 Act.[24]

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22 National Securities Markets Improvement Act of 1996 § 209(d)(3), Pub. L. No. 104-290, 110 Stat. 3416, 3436 (1996) ("Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe rules pursuant to its authority under section 6 of the Investment Company Act of 1940 to permit the ownership of securities by knowledgeable employees of the issuer of the securities or an affiliated person without loss of the exception of the issuer under paragraph (1) or (7) of section 3(c) of that Act from treatment as an investment company under that Act.").

23 17 C.F.R. § 270.3c-5.

24 Importantly, such a provision would not open a loophole that would allow for evasion of the Volcker Rule, because any investment vehicle subsidiary would itself be a banking

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We appreciate your consideration of our comments. If you have any questions or would like to discuss this further, please do not hesitate to call Robert Lee, Senior Company Counsel at (612) 667-6065, or our counsel, Virgil Mattingly of Sullivan & Cromwell LLP, at 202-956-7528.

Sincerely,

James Strother

James M. Strother
General Counsel and Senior Executive Vice President

cc: Scott C. Alvarez
(Board of Governors of the Federal Reserve System)

Julie L. Williams
(Office of the Comptroller of the Currency)

Michael H. Krimminger
(Federal Deposit Insurance Corporation)

Mark D. Cahn
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entity (by being a subsidiary of a banking entity). Thus, such a subsidiary could not engage in proprietary trading or invest in private equity funds or hedge funds in violation of the rule's prohibitions. Rather, the exemption would only permit a bank holding company to conduct its merchant banking and other permissible investment activities through subsidiaries, including those in which certain employees held a *de minimis* interest, but would not permit any activities otherwise prohibited by the Volcker Rule to be conducted by those subsidiaries.