April 1, 2020

By Electronic Submission

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Docket No. R–1694; RIN 7100–AF70

Federal Deposit Insurance Corporation
Robert E. Feldman, Secretary
Attention: Comments/Legal ESS
550 17th Street, N.W.
Washington, D.C. 20429
RIN 3064–AF17

Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street, S.W.
Suite 3E-218, Mail Stop 9W-11
Washington, D.C. 20219
Docket ID OCC–2020–0002

Securities and Exchange Commission
Secretary
100 F Street, N.E.
Washington, DC 20549-1090
File Number S7– 02–20

Commodity Futures Trading Commission
Christopher Kirkpatrick, Secretary
1155 21st Street, N.W.
Washington, D.C. 20581
RIN 3038–AE93

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

Ladies and gentlemen,

Better Markets, Inc.[1] appreciates the opportunity to submit comments on the above notice of proposed rulemaking ("Covered Funds Proposal")[2] issued by the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission (together, "Agencies"). The Covered Funds Proposal apparently would provide multiple new exclusions and institute revised regulations and guidance to ease reliance on existing exclusions, among

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 12120 (Feb. 28, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-02-28/pdf/2020-02707.pdf.

other things, potentially opening avenues for banking entities to avoid restrictions and prohibitions on investments in Covered Funds and indirect proprietary trading.

I. Meaningful public comment cannot be provided in a minimal 30-day public comment period as a consequence of the still-developing economic crisis and global pandemic.

The proposal is a lengthy, complex, and consequential rulemaking that merits serious public consideration. Unfortunately, the public is certain to provide only limited comment on the Covered Funds Proposal as a consequence of the still-developing economic crisis and global pandemic, the unprecedented actions taken by the Federal Reserve, Congress, and the Administration demanding public attention and consideration, and the resulting constraints on already limited resources and widespread disruptions across the U.S. economy.

Meaningful public comment cannot be provided within a minimal 30-day public comment period under the circumstances. The administrative record is therefore certain to remain substantially incomplete and unbalanced, undermining the fundamental purposes of the public comment process (1) to ensure a broad cross-section of the public has a fair opportunity to provide thoughtful, comprehensive comment, (2) to enable informed administrative rulemaking, and (3) to facilitate judicial review of the rulemaking process.

The Agencies have provided no rationale for their regrettable and inexplicable decision not to toll the public comment period for a consequential 300+-page rulemaking during national health and economic crises—perhaps with far reaching effects not seen since the Great Depression for some parts of the economy. Indeed, given the dramatic loss of market value and family wealth and the meteoric rise of unemployment claims since the proposal's publication in the Federal Register on February 28, 2020, immediately finalizing a proposal to permit banks to increase their exposures to various types of private investment vehicles hardly can be viewed as a critical regulatory initiative, much less one that is so critical that it requires agency and industry implementation without meaningful, thoughtful, and comprehensive public input. We view the determination to proceed with the proposal under these circumstances, and without accounting for implications of the change in market conditions, as bordering on reckless and as an unnecessary distraction from the Agencies' critical responsibilities to address ongoing concerns relating to COVID-19.

II. The proposal appears to set forth expansive new exclusions and revisions to existing exclusions and other provisions that would facilitate, if not invite, indirect speculative trading by banking entities.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")[3] was adopted in the aftermath of the banking crisis in 2008 to address deficiencies in the regulation and management of financial institutions and substantial risks that too often arise from short-term, speculative trading activities.[4] Section 619 of the Dodd-Frank Act,[5] known as the Volcker Rule, amended the BHCA

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[3] Public Law 111-203, 124 Stat. 1376 (2010).

[4] The Dodd-Frank Act's legislative history is replete with statements to this effect. See, e.g., Statement of Sen. Merkley 161 Cong. Rec. S5448 (July 22, 2015) (stating that section 619 of the Dodd-Frank Act ended "the proprietary trading that was basically large hedge funds embodied within banks being essentially done on the backs of Federal deposit insurance"); See also, e.g., Report from the Committee on Banking, Housing, and Urban Affairs: The Restoring American Financial Stability Act of 2010, Report 111-176 (Apr. 30, 2010) (stating "[t]he prohibitions in section 619 . . . will reduce potential taxpayer losses at institutions protected by the federal safety net, and reduce threats to financial stability, by lowering their exposure to risk").

[5] BHCA section 13 is codified at 12 U.S.C. § 1851.

to add new section 13 to prohibit Banking Entities from engaging in proprietary trading and sponsoring, acquiring or retaining interests in hedge funds or private equity funds (collectively, "Covered Funds"), subject to authorized exemptions in BHCA section 13(d).[6] BHCA section 13 defines "proprietary trading" to mean, in essence, engaging as principal for the "trading account"[7] of the banking entity in any transaction to purchase and sell specified financial instruments[8] and sets forth definitions and provisions relevant to Covered Fund investments.[9]

The Volcker Rule's Covered Funds provisions are intended to limit speculative investments in hedge funds and private equity funds, as well as similar types of private funds, and to prevent avoidance or evasion of banking entities' proprietary trading restrictions and prohibitions. In other words, the Volcker Rule was designed to limit speculative investments and to prevent both direct, inside-of-the-bank proprietary trading and indirect, outside-of-the-bank proprietary trading accomplished through investments in Covered Funds. Several proposed provisions appear to contravene these fundamental purposes and to instead facilitate, if not invite, speculative investments through new exclusions (or expanded existing exclusions) and revised definitions and guidance.

A. The four new proposed exclusions appear to open avenues to avoiding restrictions and prohibitions on investments in Covered Funds.

The Agencies propose four new conditional exclusions for categories of private funds that otherwise would (or might) be considered Covered Funds subject to the Volcker Rule's restrictions and prohibitions.

The four new exclusions are as follows:

- **Credit Funds Exclusion:** The proposal would exclude funds whose assets consistent solely of loans, debt securities, rights or assets related to permissible loans or debt securities (collectively, "Permissible Debt Investments"), and interest rate and foreign exchange derivatives if the written terms directly relate to and reduce interest rate or foreign exchange risks related to Permissible Credit Investments. We have concerns about the sweeping scope of the proposed exclusion. For example, the Agencies must revise, at a minimum, the "related to" and "relate to" language that could be extraordinarily broad in application and would not reasonably confine the exclusion in

[6] 12 U.S.C. 1851(d). Better Markets notes that the permitted activities exemptions in BHCA section 13(d) are authorized, not mandated, and that such authorization explicitly provides that permitted activities are subject to the broad limitations on permitted activities in BHCA section 13(d)(2) and "any restrictions or limitations" that the Agencies may determine appropriate. See 12 U.S.C. 1851(d)(2). The structure of BHCA section 13—which includes a broad prohibition on proprietary trading in BHCA section 13(a), broad statutory limits on permitted activities in BHCA section 13(d)(2), and broad authority for the Agencies to further restrict or limit permitted activities in BHCA section 13(d)(1)—makes clear that Congress intended permitted activities under the statute to be narrowly confined.

[7] The term "trading account" means, at a minimum, any account used for acquiring or taking positions in specified financial instruments principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements). 12 U.S.C. 1851(h)(6). The Agencies have the authority to define the term Trading Account to include "any such other accounts" as the Agencies determine appropriate. Id.

[8] 12 U.S.C. § 1851(h)(4). BHCA section 13(h)(4)'s definition of "proprietary trading" includes the purchase or sale for the Trading Account of "any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument" the Agencies determine to include in the BHCA section 13 analysis.

[9] See, e.g., 12 U.S.C. § 1851(a)(1)(B); 12 U.S.C. § 1851(h)(2); 12 U.S.C. § 1851(f). BHCA section 13(a)(1)(B) generally prohibits Banking Entities from acquiring or retaining any ownership interest in, or sponsoring, a covered fund, subject to authorized exemptions in BHCA section 13(d) as implemented in subpart C of the Final Volcker Rule. 12 U.S.C. § 1851(a)(1)(B).

isolation. Furthermore, while we question the need for the new exclusion entirely (especially in lieu of surgical changes to existing exclusions), we recommend that the Agencies at the very least explicitly expand the asset restrictions to prohibit investments in non-debt instruments, including all equities.

The Agencies condition the proposed exclusion on complying with certain credit fund activities restrictions, namely the fund (1) not engaging in trading activities that would constitute proprietary trading if conducted by a banking entity, and (2) not issuing asset-backed securities. In addition, a banking entity reasonably must (1) not guarantee, assume, or insure the obligations or performance of the credit fund, (2) comply with the "Super 23A" and "Super 23B" prohibitions on covered transactions with the fund, and other affiliate transaction requirements, and (3) where the banking entity sponsors or serves as investment advisor to the fund, make certain disclosures to investors (collectively, "GAD Restrictions"). Banking entities also must comply with safety and soundness requirements, including restrictions on material conflicts of interest and material exposures to high risk assets and trading strategies ("Prudential Restrictions").

We view these conditions as advisable and minimal, and they must be retained if the Agencies finalize the proposal. The proprietary trading condition, in particular, is critical; in fact, the Agencies must adopt and/or retain a cognate condition on all excluded fund investments by banking entities.

- **Venture Capital Funds:** The proposal would exclude certain funds that, among other things, (1) meet the definition of "venture capital funds" under SEC Rule 203(l)-1 and represent to investors that they pursue a venture capital strategy, (2) primarily invest in securities of qualifying portfolio companies, (3) limit investors' withdrawal rights, and (4) limit their use of leverage. Like the credit funds exclusion, venture capital funds would be prohibited from engaging in trading activities that would constitute proprietary trading if conducted by a banking entity. In addition, banking entities that invest in an eligible venture capital fund would be required to comply with the GAD Restrictions and the Prudential Restrictions.

  We are not convinced that a new categorical exclusion for high risk, venture capital investments by banking entities is necessary, and the Agencies appear to provide little more than general, conclusory statements to support such an exclusion. We do, however, acknowledge that some types of medium-to-long term investments identified as "venture capital" strategies may not be short-term, speculative trading in the nature of proprietary trading. In this regard, we encourage the Agencies to review the often cited, and most often misleadingly cited, statement of Senator Chris Dodd relating to venture capital funds, which focused on eliminating excessive risk taking by banking entities, while "preserving safe, sound investment activities that serve the public interest" through "properly conducted" venture capital investments that would "not cause the harms at which the Volcker [R]ule is directed."[10]

  The Agencies propose to address some of Senator Dodd's concerns. However, if the Agencies proceed with the proposal, they must (1) restrict all fund investments to "qualifying investments" or at least very significantly restrict investments in non-"qualifying investments" (e.g., limit them to no more than five percent of the fund's aggregate capital), (2) impose a minimum securities

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[10] See, e.g., Statement of Sen. Dodd, 156 Cong. Rec. S6242 (July 26, 2010) ("The purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason. But properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed.") (emphasis added).

holding period and portfolio company revenue limitation of $35 million (or a similarly appropriate and low figure) to ensure the fund is truly focused on medium-to-long term venture (as opposed to growth stage) investments, and (3) quantitatively limit the use of leverage as a key means for distinguishing excluded venture capital funds from statutorily prohibited activities involving private equity funds.

- **Family Wealth Management Vehicles:** The proposal would exclude funds that do not hold themselves out as raising money from investors primarily for the purpose of investing in securities for resale or disposition or otherwise trading in securities. The proposal would further require (1) a trust vehicle to have grantors that are all family customers, or (2) a non-trust vehicle be owned solely by family customers and no more than three closely related persons of such family customers.

  Banking entities would be permitted to maintain an ownership interest of up to ½% percent in the vehicle, provided such interest is necessary to establish corporate separateness ("Corporate Separateness Restriction"). In addition, an investing banking entity must (1) provide bona fide trust, fiduciary, or advisory services to the vehicle, (2) comply with Prudential Restrictions and GAD Restrictions (except that Super 23B would not apply), and (3) not purchase low-quality assets from the vehicle under Regulation W ("Asset Quality Restriction").

  The Agencies should not be using their scarce resources to prioritize special new regulatory exclusions for trusts and other investment vehicles used solely by a few of the very wealthiest American families in the middle of a pandemic and economic crisis causing massive losses of wealth, jobs, and lives. If they do, the Agencies must at least limit the "closely related" persons criterion solely to longstanding familial and personal, but not professional, relationships and apply the family limits solely to natural persons falling within referenced provisions of the Investment Advisers Act of 1940.[11]

- **Customer Facilitation Funds:** The proposal would exclude funds that facilitate transactions between a banking entity and a customer (including one or more affiliates of such customer). This proposed exclusion appears intended to permit banking entities to accept risk exposures through an expansive array of structured finance and synthetic special purpose vehicles providing customers related exposures to any "transaction, investment strategy, or other service provided by the banking entity." Customer facilitation funds would be required to comply with applicable GAD Restrictions (except that Super 23B would not apply), the Corporate Separateness Restriction, and the Asset Quality Restriction.

  The new proposed exclusion would permit, if not encourage, banking entities to increase risk exposures through funds at a time that the Agencies should be most concerned about simplifying such exposures and ensuring responsible risk monitoring and risk management. Structured transactions facilitated through one-off "customer facilitation" vehicles contravene all of these goals. Moreover, the proposed exclusion appears to encourage banking entities to actively market structured transactions through such vehicles (with no limitation that customers initiate transactions, an extremely minimal formality applicable in other contexts). In these and other respects, the proposal apparently does far too little to address indirect proprietary trading and confine the exclusion.

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[11] See, e.g., 17 CFR 275.202(a)(11)(G)-1(d)(4).

If the Agencies nevertheless proceed with the exclusion, they must at the very least set forth anti-evasion criteria and place strict limitations on permissible financial instruments, counterparty exposures, and/or active trading strategies.

B. The Covered Funds Proposal is a solution in search of a problem and contains numerous revisions to existing exclusions and other provisions that demand an opportunity for meaningful public comment.

Unfortunately, the above four new exclusions are just the tip of the iceberg. The new exclusions merely supplement additional and equally concerning elements of the proposed rulemaking, including revised and newly expanded guidance, definitions, and exclusions relating to foreign public funds, loan securitizations, small business investment companies, qualifying foreign excluded funds, ownership interests, Super 23A restrictions, and the so-called "parallel investment" exclusion. Each of these elements of the Agencies' proposal has significant implications for the effectiveness of the Covered Funds restrictions and prohibitions and demands an opportunity for meaningful, thoughtful, and comprehensive public comment through an extended public comment period of no less than 90 additional days under current circumstances.

III. Conclusion

The proposal is a lengthy, complex, and consequential rulemaking that merits serious public consideration. Unfortunately, as mentioned above, the public is certain to provide only limited comment on the Covered Funds Proposal as a consequence of the still-developing economic crisis and global pandemic, the unprecedented actions taken by the Federal Reserve, Congress, and the Administration demanding public attention and consideration, and the resulting constraints on already limited resources and widespread disruptions across the U.S. economy. We expressly reserve all rights to supplement this submission as and when time, resources, and circumstances provide an opportunity for meaningful comment.

Sincerely,

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