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Office of the Comptroller of the Currency
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Washington, DC 20219

Securities and Exchange Commission
Attention: Elizabeth M. Murphy, Secretary
100 F Street NE.
Washington, DC 20549

Commodity Futures Trading Commission
1155 21st Street, NW.
Washington, DC 20551

Federal Deposit Insurance Corporation
Attention: Robert E. Feldman, Executive Secretary
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February 13, 2012

Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Proposed Rule; 76 Federal Register 68846; November 7, 2011; Joint Notice and Request for Comment; OCC: Docket ID OCC–2011–14; **FRB:** Docket No. R–1432 and RIN 7100 AD 82; **FDIC:** RIN 3064–AD85; **SEC:** File Number S7–41–11; **CFTC:** RIN 3038-AD05

Ladies and Gentlemen:

This letter is submitted on behalf of the non-U.S. banks and affiliates of non-U.S. banks listed herein (the "**Foreign Bank Group**") in response to the request for comment on the proposed rule on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (the "**Proposed Rule**")[1] as issued by the Office of the Comptroller of the Currency (the "**OCC**"),

[1] 76 Fed. Reg. 68846 (November 7, 2011).

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Board of Governors of the Federal Reserve System (the "**Board**"), Federal Deposit Insurance Corporation (the "**FDIC**") and Securities and Exchange Commission (the "**SEC**") and the largely identical proposed rule on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Covered Funds as issued by the Commodity Futures Trading Commission (the "**CFTC**" and, together with the OCC, the Board, the FDIC and the SEC, the "**Agencies**"). The Proposed Rule would implement section 619 ("**Section 619**" or commonly referred to as the "**Volcker Rule**") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**DFA**").[2] We welcome the attention of the Agencies to the issues raised in the Proposed Rule and we appreciate the opportunity to provide the comments below.

The Foreign Bank Group is composed of internationally headquartered banks with U.S. banking operations. We join the Institute of International Bankers (the "**IIB**") and other industry groups in expressing concern about the broad implications and unintended consequences of wide-reaching restrictions on the ability of banking entities to sponsor and invest in covered funds. As members of the IIB, the members of the Foreign Bank Group fully endorse the views expressed in the IIB letter that we anticipate will be submitted during this comment period.

SUMMARY OF ISSUES

This letter is intended to focus on three key areas under the Proposed Rule that relate to covered funds restrictions and which are of particular concern to internationally headquartered banks with U.S. banking operations, with specific suggestions and answers to your questions in each area:

1. **The applicability and scope of the foreign funds exemption under the Proposed Rule.**
2. **Issues under the Proposed Rule relating to the prohibition on affiliate transactions.**
3. **The effects of the Proposed Rule on securitization and other structured products.**

Below we provide a brief summary of our recommendations followed by more detailed discussion in each of these three areas.

I. Issues Relating to the Foreign Funds Exemption under the Proposed Rule

Congressional leaders and the Agencies have expressed a clear desire to limit the extraterritorial effect of their planned restrictions on covered funds activities where those activities take place outside of the United States and otherwise meet specific requirements. In his account of the Volcker Rule, Senator Jeff Merkley explained that Section 619 acknowledges "rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law."[3] The foreign funds exemption under Section 619 (and implemented in section _.13(c) of the Proposed Rule) represents a centerpiece in this effort to preserve foreign sovereignty and avoid extraterritorial regulatory encroachment.

While the foreign funds exemption under Section 619 provides a framework which was intended to preserve such foreign sovereignty and avoid such extraterritorial regulatory encroachment, the Proposed Rule's implementation of the exemption creates uncertainty as to how the framework will apply, and appears to prohibit a wide variety of financing tools regularly used and well accepted by regulators outside the United States. Therefore it undercuts the "international regulatory comity" that Congress has sought to preserve.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (July 21, 2010). *See* Section 619, Prohibitions on proprietary trading and certain relationships with hedge funds and private equity funds.
[3] 156 Cong. Rec. S5897 (daily ed. July 15, 2010).

Specifically, as further detailed below, the Proposed Rule's implementation of the foreign funds exemption poses the following difficulties:

- both generally and when applied in the foreign funds exemption, the Proposed Rule's definition of "covered fund" greatly limits the ability of non-U.S. banking entities to sponsor and invest in foreign regulated mutual funds (a result that frustrates Congressional desire to preserve activities "permitted under relevant foreign law") and unnecessarily limits the usefulness of the exemption;

- the definition of "resident of the United States," which is a key element of the foreign funds exemption, fails to incorporate and draw upon the widely understood and applied definition of "U.S. person" under Regulation S, creating potentially significant uncertainty for market participants without protecting U.S. banks or U.S. taxpayers in any meaningful way;

- the Proposed Rule's definition of "solely outside of the United States" prohibits activities from being performed in the United States that do not involve the offer or sale to U.S. investors but which might be critical to a foreign banking entity's ability to use the foreign funds exemption; and

- using section 4(c)(9) of the Bank Holding Company Act of 1956, as amended (**"BHC Act"**), and Regulation K to set the exemption's eligibility criteria creates uncertainty as to whether a foreign banking entity will be required to apply all or only a part of the requirements that have developed under section 4(c)(9) and Regulation K.

We treat each of these concerns in the subsections below, referring in each instance to questions that the Agencies posed in presenting the Proposed Rule.

A. Change the definition and use of "covered fund" so that it works appropriately in the context of the foreign funds exemption (re questions 224, 291, 294)

A foreign banking entity that it is eligible to apply the foreign funds exemption, must ensure under sections _.13(c)(1)(iii) and (iv): (i) that it does not offer for sale or sell any interest in a covered fund to a U.S. resident; and (ii) that any activities involved in acquiring, retaining or sponsoring a covered fund occur "solely outside of the United States."

Below we examine each of these requirements. As an initial matter, however, we believe it is important to highlight that the interplay of these requirements with the Proposed Rule's expansive definition of "covered fund" vitiates Congress's intention that the Proposed Rule would respect "rules of international regulatory comity" in allowing foreign banking entities that operate outside of the United States "to engage in activities permitted under relevant foreign law."

Section 619 defined "private equity fund" and "hedge fund" by reference to funds that would be investment companies under the Investment Company Act of 1940, as amended (the "Investment Company Act"), but for the exemptions provided by sections 3(c)(1) or 3(c)(7) thereof. This approach made clear that fund vehicles which are investment companies and, thus, required to be registered under the Investment Company Act (if not exempt under another provision of the Investment Company Act), do not fall within the purview of the ban on investing in and sponsoring covered funds.

The Proposed Rule goes further than what is set forth in Section 619, and includes the following addition to the definition of "covered fund" at section _.10(b)(1):

> Any issuer, as defined in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(22)), that is organized or offered outside of the United States that would be a covered fund as defined in paragraphs (b)(1)(i), (ii), or (iv) of this section, 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.

In relation to this addition, the Agencies ask at question 224 whether the Proposed Rule's "language on non-U.S. entities correctly describe[s] those non-U.S. entities ... that should be included in the definition of 'covered fund'" and in a later, related question, question 294, the Agencies ask whether the foreign funds exemption is "consistent with respect to national treatment for foreign banking organizations." For the reasons described below, we believe that non-U.S. entities are not correctly described and the exemption is not consistent. Specifically, we believe that the definition of "covered fund" is overbroad.

To understand why the attempt to delineate non-U.S. entities is too broad, we turn to the Agencies' stated reason for adding section _.10(b)(1):

> These entities have been included in the proposed rule as "similar funds" given that they are generally managed and structured similar to a covered fund, except that they are not generally subject to the Federal securities laws due to the ... fact that they are not organized in the United States or one or more States.[4]

The Agencies specifically intended to capture foreign funds that are "generally managed and structured similar to" private equity funds and hedge funds. However, the Proposed Rule may be read (apparently against the Agencies' intent) to include regulated foreign investment companies (such as European Undertakings for Collective Investment in Transferable Securities, or "**UCITS**") that are not at all similar in structure to private equity funds or hedge funds but which, if offered to U.S. residents, would likely be offered in reliance on sections 3(c)(1) or 3(c)(7) of the Investment Company Act.[5]

Further, the Proposed Rule appears to capture certain bank-sponsored pension plans and retirement plans organized in non-U.S. jurisdictions. Prior to the Proposed Rule, these funds would have been outside the scope of the Investment Company Act because they are organized outside of the U.S. and have only non-U.S. investors. However, with the changes set forth in the Proposed Rule, these regulated foreign pension plans and retirement funds could be determined to be "covered funds." In Canada, many of these funds are sponsored or affiliated with banking entities. The Agencies must make it clear that foreign pension plans and other regulated retirement funds will not be considered "covered funds." In particular, the Agencies should make it clear that that such a bank-sponsored or affiliated pension plan established for its employees is not a "covered fund" and is not otherwise subject to any of the trading, investing, or Section 23A Provision (see below) restrictions or prohibitions under the Proposed Rule.

As a result, the Proposed Rule permits banking entities to sponsor and invest in U.S. mutual funds but could be read not to permit such entities to sponsor or invest in UCITS or other foreign investment funds that are structured and closely regulated in accordance with local requirements for retail investors. A European bank that

[4] When the Agencies refer to foreign funds that are "generally managed and structured similar to a covered fund", we assume that they mean "generally managed and structured similar to an issuer that would be an investment company as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act." Were this not the case, we believe the language would be circular.

[5] A foreign investment company, even if regulated in its home jurisdiction, must nevertheless qualify for an exemption from registration as an investment company under the Investment Company Act. These companies frequently rely on Section 3(c)(1) or 3(c)(7), even though they do not operate in a manner similar to private investment funds, such as hedge or private equity funds.

is a covered banking entity could be left with no option but to organize and offer UCITS either in accordance with the foreign funds exemption or generally in compliance with the Proposed Rule's conditions for sponsoring and investing in covered funds. This result, which could occur in any non-U.S. jurisdiction with a regulated funds regime, highlights the extent to which the Proposed Rule encroaches on (and creates potential layers of redundancy in relation to) foreign regulated funds regimes and illustrates the type of extraterritorial reach that Congress sought to avoid when enacting Section 619.

Accordingly, we suggest that the Agencies amend section _.10(b)(1) of the Proposed Rule to explicitly exclude or exempt regulated foreign investment companies and include the reasoning for this exemption in the accompanying adopting release.

B. Change the definition of "resident of the United States" to instead refer to Rule 902 of Regulation S (re question 295)

As mentioned above, one of the key requirements of the foreign funds exemption is that a covered foreign banking entity cannot offer or sell any interest in a covered fund to a "resident of the United States." The Proposed Rule introduces a definition of "resident of the United States" (section_.2(t)) that differs from the definition of "U.S. person" under Rule 902 of Regulation S under the U.S. Securities Act of 1933, as amended. The Agencies note that the proposed definition is "similar to but not identical" to the definition of U.S. person under Regulation S.

At question 295, the Agencies ask whether this definition of resident of the United States is effective in the context of the foreign funds exemption and, at question 139, the Agencies ask whether the definition of "resident of the United States" should more closely track the definition of "U.S. person" in Regulation S. We believe the current definition of "resident of the United States" has the potential to create unnecessary uncertainty in the market, and that the term should be defined by reference to the definition of "U.S. person" in Regulation S. Market participants are familiar with and understand the Regulation S definition. When sponsors of private funds enter the market and wish to direct their offering of fund interests to investors outside of the United States, their offering documentation invariably references the definition of "U.S. person" at Rule 902 of Regulation S. Use of Rule 902 in the context of the foreign funds exemption (and the Proposed Rule more generally) will allow the Agencies to meet the same aim while using an approach that is familiar to market participants. By using the Regulation S definition to form the core of the definition of resident of the United States in the Proposed Rule, the Agencies could avoid confusion and interpretive issues by drawing upon the market's familiarity with the term and upon the substantial body of case law and SEC interpretation and commentary that provide gloss to the term "U.S. person."

We request that the Agencies amend the Proposed Rule at section _.2(t) to refer to "U.S. person, as such term is defined under Rule 902 of Regulation S." This approach allows market participants to rely upon the common understanding of and body of law and regulation interpreting "U.S. person" under Regulation S.

C. Reassess the scope of activities that must be performed "solely outside of the United States" (re question 293)

The final requirement that a covered foreign banking entity must observe when seeking to apply the foreign funds exemption is that the relevant sponsoring or investment activities must take place "solely outside of the United States." The Agencies define this phrase in three steps at section _.13(c)(3) of the Proposed Rule:

(i) the covered banking entity engaging in the activity is not organized under the laws of the United States or of one or more States;

(ii) no subsidiary, affiliate, or employee of the covered 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 or in one or more States; and

(iii) no ownership interest in such covered fund is offered for sale or sold to a resident of the United States.

Referring to these provisions, question 293 asks whether they are "effective and sufficiently clear." We believe that the effectiveness and clarity of the proposed provisions could be significantly improved.

1. Delete the Prohibition on Sales Activity by U.S. Entities and Employees

As an initial observation, we note that prongs (i) and (iii) of section _.13(c)(3) are each redundant with other provisions of the Proposed Rule. Section _.13(c)(3)(i) overlaps with what sections _.13(c)(1)(i) and (ii) already require, and section _.13(c)(3)(iii) repeats verbatim the wording of section _.13(c)(1)(iii). This leaves us with _.13(c)(3)(ii), which (with its requirement that "no subsidiary, affiliate, or employee of the covered 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") goes beyond the language and approach suggested by Section 619.

The language at section _.13(c)(3)(ii) seems to stem generally from the sentiment embodied in Senator Merkley's remark that Section 619 seeks to "maintain a level playing field by prohibiting a foreign bank from improperly offering its hedge fund and private equity fund services to U.S. persons when such offering could not be made in the United States."[6] The Proposed Rule is too broad, however, as it would pick up sales activity directed outside of the United States to non-U.S. persons.

Specifically, because the Agencies have defined "covered fund" so that the term could be read to include all private funds anywhere in the world whether or not offered or sold to U.S. Persons, using the term "covered fund" in the context of the "solely outside of the United States" requirement of the foreign funds exemption can limit the ability of eligible foreign banking entities to use the exemption. In answer to question 291 (whether the Proposed Rule's implementation of the foreign funds exemption is effective), we believe that the Proposed Rule implements the exemption in a way that limits its usefulness for its intended beneficiaries while giving no benefit to U.S. taxpayers and offering no reduction in systemic risk. To illustrate this point, consider the following example: a French bank (which is a covered banking entity) would like to offer an interest in a French structured investment fund ("**SIF**") to a high net worth investor in Italy; however, the relationship with the Italian investor is held by an employee of the French bank's subsidiary in New York, and this primary contact would typically be the individual who solicits the high net worth investor. In the example above, the definition of "covered fund" may be read to include the SIF and the requirements of section _.13(c)(3)(ii) could mean that the French bank selling a French SIF cannot contact an Italian investor through its primary contact because such contact happens to be in New York. Preventing offshore clients of a banking entity from dealing with their normal U.S. contacts disrupts the ability of the banking entities to appropriately service their clients and offers no benefit to the U.S. taxpayer nor does it reduce risk. Additionally, client service teams may be moved offshore, reducing employment in the U.S.

Furthermore, in the example set out above, the New York subsidiary soliciting the Italian investor is registered as a broker-dealer and therefore subject to regulation by the SEC and the Financial Industry Regulatory Authority ("**FINRA**"). Given this existing regulation and oversight, the Proposed Rule's prohibition on offer and sale activities in the U.S. to non-U.S. residents is superfluous and does not further the goals of the DFA or the Proposed Rule.

[6] 156 Cong. Rec. S5897 (daily ed. July 15, 2010).

Accordingly, we respectfully request that the Agencies delete section _.13(c)(3)(ii).

2. The Foreign Funds Exemption Should Allow All Activity Unrelated to Sales to Residents of the U.S.

The Agencies have recognized that foreign banking entities engage in some activities in the United States, such as "back office functions," which do not constitute selling to U.S. investors and therefore would not affect availability of the foreign funds exemption, commenting specifically that "an employee or entity with no customer relationship and involved solely in providing administrative services or so-called 'back office' functions to the fund as incident to the activity permitted under [the foreign funds exemption] (such as clearing and settlement or maintaining and preserving records of the fund with respect to a transaction where no ownership interest is offered for sale or sold to a resident of the United States) would not be subject to this requirement."

Beyond this explicit exemption for back office functions, we ask that the Agencies make clear in respect of the "solely outside of the United States" requirement that all activities that do not include selling or offering interests in a covered fund to U.S. residents will not be subject to its requirements (and, therefore, permitted under the foreign funds exemption). We note that many activities integral to managing a fund do not fall under the rubric of "offering or selling to" investors. Often, a portfolio management team will consist of a number of individuals, only a small number of whom may be engaged in selling activities. Examples of non-selling activities that the Agencies need to make clear are permissible include establishing the fund vehicles, day-to-day management and deal sourcing, trading, investment advisory activities, tax structuring, obtaining licenses, interfacing with regulators and many other activities. None of these activities will necessarily involve U.S. sales activity and must not be prohibited solely by virtue of the location of such personnel.[7]

In providing this clarification, the Agencies will allow U.S. financial centers like New York to retain jobs of individuals who work for foreign banking entities and their affiliates performing non-selling activities in respect of covered funds which are offered outside of the United States. In the face of uncertainty, non-U.S. banking entities may move these functions overseas, creating unnecessary costs for the institutions and resulting in the loss of a large number of jobs in the U.S. As noted above, a portfolio management team will often consist of a large number of individuals, only a small number of whom are involved in sales activities. However, a non-U.S. financial institution will have little incentive to keep personnel in the U.S. if a portion of a management team is required to be housed in a non-U.S. jurisdiction, resulting in a ripple effect of job losses even outside of the sales sector. Such a result would not only harm the U.S. job market, it would also undermine the purpose of the rule by moving operations outside of the U.S. and, as a result, making the operation of such institutions more opaque to U.S. regulators.

D. Refer to section 4(c)(9) and subpart B of Regulation K solely in the context of their QFBO requirements (re question 292)

Before applying the foreign funds exemption, a non-U.S. banking entity must first determine whether it is eligible to rely on the exemption. In setting eligibility, section _.13(c)(1) of the Proposed Rule imposes two important threshold requirements: (i) that the foreign banking entity cannot be "directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States" and (ii) that the activities of the foreign banking entity must be "conducted pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act." Expanding on the latter requirement, section _.13(c)(2)(i) of the Proposed Rule explains that an activity will be deemed to be conducted under section 4(c)(9) under the following circumstances:

[7] In addition to permitting non-sales activity in the U.S., as discussed earlier in this subsection, we also request the Agencies to permit *sales* activity in the U.S. when directed to persons who are not residents of the U.S.

> With respect to a covered banking entity that is a foreign banking organization, the banking entity is a qualifying foreign banking organization and is conducting the purchase or sale in compliance with subpart B of the Board's Regulation K (12 CFR 211.20 through 211.30).

In assessing this second threshold requirement, the Agencies ask at question 292: "Are the proposed rule's provisions regarding when an activity will be considered to be conducted pursuant to section 4(c)(9) of the BHC Act effective and sufficiently clear?" We believe that the conduct referred to by the Proposed Rule must be expressly limited to the QFBO test. As we understand, the Agencies intended to specify the qualifying foreign banking organization (or "**QFBO**") requirements in the Proposed Rule.[8] However, the Board has issued rules and interpretive guidance under section 4(c)(9) and subpart B of Regulation K that go beyond the specific requirements which a foreign banking organization must meet to be considered a QFBO. The language of section __13(c)(2)(i) is ambiguous in that it would appear to include these additional requirements under section 4(c)(9) and subpart B of Regulation K, which we do not believe was the Agencies' intent.

We recommend that the Agencies amend section _.13(c)(2)(i) by deleting the following phrase: "and is conducting the purchase or sale in compliance with subpart B of the Board's Regulation K (12 CFR 211.20 through 211.30)." By imposing the requirement to be a QFBO, the Agencies by definition will require foreign banking entities to comply with section 211.23(a) of Regulation K as a prerequisite to using the foreign funds exemption. To additionally require compliance with subpart B of Regulation K introduces uncertainty for foreign banking entities as to the scope of other rules or guidance that may apply in addition to the QFBO requirements of section 211.23(a) of Regulation K before they can benefit from the foreign funds exemption.

We note that because a practically identical threshold requirement applies in respect of the exemption to the ban on proprietary trading for trading outside of the United States, the Agencies should for the sake of consistency make an identical change at section _.6(d)(2)(i) of the Proposed Rule.

II. Issues Relating to the Prohibition on Affiliate Transactions

In addition to the concerns surrounding the narrow scope of the foreign funds exemption discussed in section I above, the Foreign Bank Group also has serious concerns about the extraterritorial and other effects of the Proposed Rule's broad prohibition on transactions between banking entities and covered funds for which such banking entities serve as investment manager, investment adviser, commodity trading advisor, or sponsor, or which are organized or offered by banking entities under the Proposed Rule's asset management exemption (**"Advised Funds"**). The Agencies have asked in question 314, "Is the proposed rule's approach to implementing the limitations on certain transactions with a covered fund effective? If not, what alternative approach would be more effective and why?" We strongly object to the scope of the Proposed Rule's limitations on transactions with Advised Funds for the following reasons:

(i) as written, the Proposed Rule's prohibition on covered transactions with Advised Funds applies even to Advised Funds that are exempt from the Proposed Rule's investment prohibition, including pursuant to the foreign funds exemption, which broad application extends beyond the scope of Section 619 representing an extraterritorial intrusion that is not authorized by the statute; and

(ii) the Proposed Rule's outright prohibition on covered transactions between banking entities and Advised Funds is broader than necessary under Section 619's ambiguous language, which could instead be interpreted to apply the quantitative and qualitative restrictions of section 23A of the

[8] The Proposed Rule defines a "qualifying foreign banking organization" as "a foreign banking organization that qualifies as such under § 211.23(a) of the Board's Regulation K (12 CFR 211.23(a))."

Federal Reserve Act ("**Section 23A**"), and an outright prohibition will cause significant disruption and economic harm to banking entities and Advised Funds.

We treat each of these concerns in the subsections below.

A. Make clear that if a covered fund qualifies under an exemption, it is also exempt from the limitations on covered transactions (re question 314)

We urge the Agencies to make clear that the Proposed Rule's prohibition on covered transactions between banking entities and their Advised Funds ("**Advised Fund Transactions**") does not apply to funds that are otherwise exempt from the Proposed Rule's investment prohibition.

Prohibiting Advised Fund Transactions between banking entities and Advised Funds in which they are otherwise permitted to invest is no more authorized by the text of Section 619 than is a prohibition on exempted investments themselves, which have been appropriately carved out of the prohibition on Advised Fund Transactions in section _.16(a)(2)(i) of the Proposed Rule. The Agencies should provide a similar carve-out for Advised Fund Transactions with Advised Funds relying on investment exemptions.

There is no apparent policy justification for a prohibition on lending or other extensions of credit, asset sales or other transactions falling within Section 23A's definition of "covered transactions" when equity investment is permitted. Historically, the aim of Section 23A has been to insulate banks, who benefit from the federal safety net, from credit exposure to their riskier affiliates. The prohibition on Advised Fund Transactions appears aimed at the same objective, but with protection of the larger bank holding company group, rather than the single bank, in mind. From that perspective, we note that equity investment is the riskiest form of credit exposure, with a possibility of total loss. A banking entity should not be barred from making a loan to an Advised Fund where it could instead make an equity contribution, given that the equity contribution entails a greater risk of loss.

Further, the Proposed Rule would prohibit transactions between foreign banking organizations and their foreign Advised Funds, even in the absence of any U.S. nexus. This would represent an unauthorized and unacceptable extraterritorial intrusion by the Agencies on the rightful jurisdiction of foreign banks' home country regulators. Due in part to the expansive definition of "covered fund" discussed in section I.A above, such a prohibition would have detrimental effects not just on fund structures with a U.S. nexus, but also on fund structures located entirely outside the United States. These transactions between foreign banking entities and their Advised Funds have no direct effect on the U.S. economy. Under principles of international comity and regulatory deference, local laws and regulations should govern activities permissible for local financial institutions (particularly in the highly regulated funds space) in the context of transactions that are solely outside the United States. Without clarification, the prohibition on Advised Fund Transactions contravenes these regulatory principles. There is simply no justification for applying the prohibition on Advised Fund Transactions to funds relying on an investment exemption, on the one hand, and all foreign branches, affiliates and subsidiaries of a banking entity throughout the world, on the other. This extraterritorial intrusion is not authorized by the statute and, under the longstanding presumption against extraterritorial application of U.S. law absent clear Congressional intent, cannot be unilaterally imposed by the Agencies.

To illustrate the consequences of applying the prohibition on Advised Fund Transactions to all covered funds regardless of exemption, consider the following:

(iii) *European private fund.* A private fund organized in France by an affiliate of a French bank with no U.S. investors and no other connection to the United States.[9] The French bank has a U.S. branch, and therefore both it and its affiliates are "covered banking entities" under the Proposed Rule. Because "covered funds" includes foreign funds that, if they had U.S. investors, would have to rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act, the private fund would likely be a "covered fund" under the Proposed Rule. The French bank affiliate could likely rely on the foreign funds exemption to acquire an ownership interest in the fund. However, under the Proposed Rule, neither the French bank affiliate nor any other entity in the bank holding company group could engage in any other type of covered transaction, including, *inter alia*, any loan or other extension of credit (including in connection with custody services[10]), securities lending or repo transaction or derivative transaction, with the private fund even if legally permissible under local law. Moreover, any transaction between the banking entity and its affiliates and the covered fund would be subject to Section 23B, imposing a significant compliance and reporting burden.

(iv) *ABS issuer.* A covered fund that is an issuer of asset-backed securities relying on the loan securitization exemption. As discussed in greater detail in section III.B below, we would argue that such issuers should not be included in the definition of covered funds in the first place. However, to the extent such issuers are not ultimately excluded from the covered funds definition, under the loan securitization exemption, such an issuer could engage in interest rate and foreign exchange swaps to hedge its exposure to loans. However, because of the prohibition on covered transactions, it could not enter into such derivative transactions with the banking entity that organized it, as is currently common practice. Instead, the covered fund would have to seek such hedging from a third party institution, adding transaction costs and administrative burden, particularly given that in the current market institutions seldom offer such products to third parties. Similar issues arise with any cash advances, other extensions of credit, repurchase obligations, etc., on more than an intraday basis.

The Agencies have already recognized the need to explicitly exempt from the limitation on Advised Fund Transactions a banking entity acquiring or retaining an ownership interest in a covered fund that is otherwise in accordance with the Proposed Rule.[11] We urge the Agencies to go a step further to clarify that if a banking entity is permitted under an exemption to acquire and retain an ownership interest in a covered fund, other covered transactions with that fund likewise should not be prohibited, nor should the restrictions of Section 23A apply.[12] We urge the same clarification in respect of the application of Section 23B to all transactions between banking entities and their Advised Funds, as contemplated in section _.16(b) of the Proposed Rule. We ask that the Agencies clarify these points, as they are of critical importance to banking organizations, and in particular to foreign banks.

[9] We note that if our comments on the definition of "covered fund" in section I.A above are not addressed, the same analysis could apply even to registered, highly regulated foreign funds such as UCITS and SIFs.

[10] Custodians regularly provide short-term extensions of credit to their customers in the ordinary course of providing custodial services, which extensions may be longer than on an intraday basis. Limitations on a covered fund's ability to utilize an affiliated custodian would be particularly onerous in certain jurisdictions where a very limited number of custodians are active in the market. Preventing foreign funds relying on the foreign funds exemption from utilizing affiliated custodians in markets where such custodians are the best available does nothing to reduce risk to the U.S. financial system, has the potential to harm underlying shareholders and ultimately constitutes inappropriate extraterritorial interference.

[11] 76 Fed. Reg. at 68916.

[12] See Footnote 9.

B. Directly apply the quantitative and qualitative restrictions of Section 23A to transactions between banking entities and covered funds that they sponsor or advise, rather than imposing an outright prohibition on those transactions (re question 314)

The Proposed Rule in section _.16(a)(1) imposes an outright prohibition on "covered transactions" as defined in Section 23A between (a) a banking entity and its affiliates and (b) covered funds for which the banking entity serves as investment manager, investment adviser, commodity trading advisor, or sponsor, or which is organized or offered by the banking entity under the Proposed Rule's asset management exemption.[13] The text of Section 619 supporting this restriction, found in section 13(f)(1) of the BHC Act as added by Section 619 (the "**Section 23A Provision**"), is, however, ambiguous as to whether an outright prohibition, or merely application of Section 23A's quantitative and qualitative restrictions, is required. We urge the Agencies to reconsider their interpretation of the Section 23A Provision to impose Section 23A's quantitative and qualitative restrictions on Advised Fund Transactions, rather than to prohibit Advised Fund Transactions.

Under established principles of administrative law, "[a| statute is ambiguous if it gives rise to more than one reasonable interpretation."[14] When a statute is ambiguous, "a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency" charged with implementing the statute.[15] It therefore falls within the discretion of the agency or agencies administrating a statute to resolve any statutory ambiguity, so long as the result is a reasonable interpretation of otherwise ambiguous statutory text.

The language of the Section 23A Provision is ambiguous because it is internally inconsistent. On the one hand, it states that "[n|o banking entity . . . may enter into a transaction with the |Advised Fund| . . . that would be a covered transaction, as defined in |Section 23A|." This language suggests an outright prohibition on covered transactions with Advised Funds, in contradiction to Section 23A's approach of quantitative and qualitative restrictions and collateral requirements. On the other hand, the Section 23A Provision concludes by saying such restriction will be imposed "as if such banking entity and the affiliate thereof were a member bank and the [Advised Fund| were an affiliate thereof." This language suggests that the intention is in fact to apply Section 23A to transactions between the banking entity and the covered fund on its existing terms. The language is therefore susceptible to two reasonable interpretations: either it prohibits Advised Fund Transactions, or it imposes the restrictions set out in Section 23A on Advised Fund Transactions.

Language elsewhere in Section 619 in respect of application of section 23B of the Federal Reserve Act ("**Section 23B**") to Advised Fund Transactions adds to the ambiguity in respect of the Section 23A Provision. Section 13(f)(2) of the BHC Act, as added by Section 619 (the "**Section 23B Provision**"), provides that banking entities that sponsor or advise Advised Funds "shall be subject to [Section 23B]..., as if such banking entity were a member bank and such [Advised Fund| were an affiliate thereof." The unambiguous effect of this provision is to impose Section 23B's arms-length requirement on transactions between banking entities and their Advised Funds. Because this provision and the Section 23A Provision mirror one another in stating that application should be "as if such banking entity were a member bank and such [Advised Fund| were an affiliate thereof," it would be reasonable to conclude that the provisions should be interpreted consistently to apply Section 23A and Section 23B, respectively, directly in this new context. Further, if Advised Fund Transactions are prohibited in their entirety, the Section 23B Provision would by this interpretation be made largely superfluous. While there are certain transactions that would be picked up by the Section 23B Provision even if the Section 23A Provision is interpreted as a complete prohibition on Advised Fund Transactions, the scope of the Section 23B Provision would be extremely narrow in such a case, limited to Advised Fund Transactions that are exempted from the

[13] Proposed Rule §_.16, 76 Fed. Reg. 68846, 68954 (proposed Nov. 7, 2011).

[14] *DeGeorge v. U.S. District Court for the Central District of Cal.*, 219 F.3d 930, 939 (9th Cir. 2000).

[15] *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 844 (1984).

Section 23A Provision and transactions that are covered by Section 23B but are not included in Section 23A's definition of "covered transaction." The more logical reading would be that the Section 23A Provision and the Section 23B Provision are intended to be coterminous as traditional Section 23A and Section 23B are.

When statutory text is ambiguous, courts may look to legislative history for interpretive guidance to determine if an administrative agency's interpretation is reasonable.[16] The legislative history of the Section 23A Provision provides no definitive guidance in interpretation, with some statements in the Congressional Record suggesting an outright prohibition of Advised Fund Transactions and others suggesting that Section 23A should be directly applied to such transactions.[17] Legislative history therefore is not conclusive in dictating how the Agencies must interpret the language of the Section 23A Provision.

In the face of this statutory ambiguity, the Agencies are free to choose any reasonable interpretation of the statutory text. We are therefore surprised that the Agencies have not even acknowledged this ambiguity in the Preamble, nor have they explained the reasoning behind their decision to follow the more restrictive interpretation. We would urge the Agencies to interpret the Section 23A Provision in a manner that meets intended policy goals and is as consistent as possible with the long-standing Section 23A regime for addressing risks involved in affiliate transactions. Direct application of Section 23A's restrictions to Advised Fund Transactions would achieve this end.

There is no clear policy reason why limitations on Advised Fund Transactions should be more restrictive than the equivalent limitations between banks and their affiliates. Historically, the regulatory approach has been to provide the most protection to depository institutions that benefit from the federal safety net of deposit insurance and access to the Federal Reserve discount window, and less stringent protection for other members of a bank holding company group. The quantitative and qualitative requirements of Section 23A, combined with the arms-length requirements of Section 23B, have historically been viewed as sufficient to protect depository institutions from ill-advised transactions with their riskier affiliates, and beyond adding derivatives and similar transactions to the list of covered transactions under the statute, the DFA has not changed that regime. It is therefore unclear why, in the context of Advised Fund Transactions, the approach would be to prohibit such transactions entirely. Direct application of Section 23A's restrictions should serve the goal of insulating banking entities from risks related to exposure to Advised Funds, and together with Section 23B's arms-length requirements should mitigate any conflicts of interest. An outright prohibition is not necessary to achieve this goal.

Further, an absolute prohibition on Advised Fund Transactions will cause significant disruption and economic harm to banking entities and Advised Funds. Banking entities regularly provide a wide range of services to their Advised Funds beyond pure investment advisory services, including some services that entail extensions of credit, custody (and related extensions of credit), warehousing of investments, various types of derivatives and other transactions that would be deemed covered transactions under Section 23A. There will be costs and inefficiencies involved in sourcing third party vendors for these services.

Given the ambiguity in the statutory language and the lack of a clear policy reason to ban, rather than restrict, covered transactions between banking entities and their Advised Funds, we urge the Agencies to err in favor of the interpretation that will protect banking entities and not needlessly cause harm to existing structures, and to apply Section 23A's quantitative and qualitative restrictions, rather than an outright ban, on Advised Fund Transactions.

[16] *See A-Z Int'l v. Phillips*, 179 F.3d 1187, 1192 (9th Cir. 1999).

[17] *Compare* 156 Cong. Rec. S5870, S5898 (daily ed. Jul. 15, 2010) (statement of Sen. Merkley) (describing Section 619's provision in respect of Section 23A as a "broad prohibition" on covered transactions between banking entities and funds sponsored or advised by them) *with id.* at S5898 (statement of Sen. Hagan) (noting that the same provision "applies" Section 23A to banking entities and funds sponsored or advised by them); *see also* Douglas Landy et al., *Looking Back While Forging Ahead: What the History of Restrictions on Bank Affiliate Transactions May Tell Us About the Impact of the Dodd-Frank Changes*, 128 BANKING L.J. 588, 608 (2011).

C. The Board should use its definitional power under the Federal Reserve Act to define "covered transaction" more narrowly for purposes of transactions between banking entities and covered funds (re question 314)

As discussed above, there are several cases in which an outright ban on Advised Fund Transactions neither makes sense nor furthers the aims of the Volcker Rule. The Agencies have repeatedly indicated that they have no exemptive authority under Section 619's provisions on Advised Fund Transactions. We would like to point out, however, that the Board does have authority under the Federal Reserve Act to define what constitutes a "covered transaction," as they have done in Regulation W.[18] This authority gives the Board room to interpret what a "covered transaction" can be with respect to Advised Funds Transactions not entered into by an insured U.S. bank (or the U.S. branch of a foreign bank). The Agencies should consider whether some of the issues noted above could or should be addressed through this interpretive power of the Board. The Board could, for example, include in a revised Regulation W a bifurcated definition of "covered transaction," with one definition tailored for and appropriate to the relationship between banks and their affiliates and one tailored for and appropriate to the relationship between banking entities and covered funds subject to the Proposed Rule. Alternatively, a mechanism could be put in place whereby an affected banking entity could come to the Board to request an exemption, not from §_.16 itself, but from the definition of "covered transaction." This is another regulatory tool at the Agencies' disposal to address the very significant effects of an outright prohibition, in all cases, of Advised Fund Transactions. We urge the Agencies to use it.

III. Issues for Securitization, Structured Products and Covered Bonds

A. The Agencies not only have the authority to revise the Proposed Rule to clearly permit loan securitizations, but are mandated to do so

DFA Section 619(g)(2) requires as an overriding rule of construction that the Volcker Rule not be "construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law" (the "**Securitization Authorization**"). Any limitation or restriction, regardless of how small, on the ability of a banking entity to sell or securitize loans is beyond the authority of the Agencies. We find no reasonable basis for the extensive regulatory restrictions as they are set forth in the Proposed Rule. The rules and regulations implementing the Volcker Rule, therefore, need to be narrowly drafted and interpreted to avoid any risk that such rules or regulations would restrict or limit, in any manner, the ability of a banking entity to sell or securitize loans. This is an overriding principle by which the provisions of the Volcker Rule must be read and is not prescriptive in the manner in which it is to be incorporated into the Proposed Rule.

Furthermore, the legislative history of the DFA refers to hedge funds and private equity funds as commonly understood, and not the broader definition of "covered funds" suggested under the Proposed Rule.[19] As noted in the FSOC study[20], "[u]nder certain circumstances, sponsorship of hedge funds and private equity funds may be a potential source of risk and liquidity stress to banking entities."

As has been recognized in other regulatory reform contexts, securitizations and structured products continue to be important tools for the U.S. economy (see, for example, the FSOC study on Risk Retention, which recognized securitization as "an important source of credit formation for the economy"). The Agencies' ability to grant exemptive relief under Section 619(d)(1)(J) for activities that "promote and protect the safety and soundness of

[18] *See* 12 C.F.R. § 223.3(h).

[19] *See*, the colloquy between Representative Jim Himes and Barney Frank, 156 Cong. Rec. H5226 (daily ed. June 30, 2010). *See also*, the colloquy between Senator Chris Dodd and Barbara Boxer, 156 cong. Rec. S5904 (daily ed. July 15, 2010).

[20] The Financial Stability and Oversight Council ("**FSOC**") Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (January 2011).

the |relevant| banking entit|ies|, as well as the financial stability of the United States" would allow the Agencies to make the following suggested changes to the Proposed Rule.

B. Revise the definition of "covered funds" to apply only to hedge funds and private equity funds and exclude securitization and structured product issuers, as intended by DFA Section 619 (re question 217)

We respectfully request that the Agencies expressly exclude issuers of asset-backed securities and structured products from the definition of covered funds to give effect to the Securitization Authorization. Such an exclusion would be the clearest method for avoiding any potential limitation or restriction on a banking entity's ability to sell or securitize loans. As we discuss below in III.C, merely providing a loan securitization exemption, does not give effect to the Securitization Authorization because any such exemption would be limited in scope and the Securitization Authorization is a broad authorization for banking entities to continue selling or securitizing loans, as discussed above in III.A.

Although the DFA refers to "hedge funds" and "private equity funds," it defines them by reference to reliance on sections 3(c)(1) and (3)(c)(7) of the Investment Company Act. As discussed in section I.A above, there are numerous securitization structures and structured products that would not fall within the traditional definition of hedge fund or private equity fund, but rely on section 3(c)(1) or (3)(c)(7) of the Investment Company Act. As we set forth below, these products serve important liquidity and risk management functions and should be excluded from the definition of "covered fund" to give effect to the Securitization Authorization. Further, as described in section I.A above, the broad reach of the definition of covered fund likely captures foreign entities that have little or no real connection to the United States. In choosing to define covered fund merely by reference to an issuer's reliance upon on section 3(c)(1) or (3)(c)(7) of the Investment Company Act, the Agencies failed to follow the Securitization Authorization's mandate that the Volcker Rule not limit or restrict securitizations. This approach will severely restrict many future securitizations.

As noted in the FSOC study: "Although widely used by traditional hedge funds and private equity funds, these statutory exclusions |sections 3(c)(1) and 3(c)(7)| were not designed to apply only to such funds. As such, they do not specifically address or closely relate to the activities or characteristics that are typically associated with hedge funds or private equity funds. In implementing the Volcker Rule, Agencies should consider criteria for providing exceptions with respect to certain funds that are technically within the scope of the "hedge fund" and "private equity fund" definition in the Volcker Rule due to their reliance on 3(c)(1) or 3(c)(7) of the Investment Company Act that Congress may not have intended to capture in enacting the statute."

Alternatively, we respectfully request that the Agencies revise the definition of covered fund to expressly define hedge funds and private equity funds. In this respect, we endorse the definitions for such terms as proposed by the Securities Industry and Financial Markets Association in its "*Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and. Private Equity Funds*" submitted to the Agencies with respect to the Proposed Rule.

C. The regulations relating to the loan securitization exemption must be broadened to include more entities created to securitize assets (re question 297)

If the Agencies do not revise the definition of covered fund to exclude issuers of asset-backed securities and structured products, despite the mandate to do so in the Securitization Authorization, we respectfully suggest that compliance with the mandate of the Securitization Authorization requires that the loan securitization exemption included in the Proposed Rule be broadened in scope. The proposed loan securitization exemption is too limited in scope and too narrowly drafted to give effect to the Securitization Authorization for the reasons set out below.

(i) Most securitizations provide for cash sitting in collection accounts or reserve accounts to be invested in "permitted investments," which could include certain types of securities. The ability to invest in "permitted investments" is crucial to the economics of these securitization structures; however, the proposed loan securitization exemption does not expressly permit issuers of asset-backed securities ("**ABS**") to hold "permitted investments." We respectfully request that the Agencies revise the loan securitization exemption to clarify that proceeds held in short-term eligible investments would be permitted.

(ii) In certain securitizations of loans, such as a collateralized loan obligations (a "**CLO**"), the lender (i.e., the covered fund) will often receive equity or other similar interests in the borrower in the event that a securitized loan becomes distressed and is restructured. This exchange of the loan for the equity or similar interest benefits the holders of the CLO, who could otherwise take a substantial writedown with respect to the distressed loan. Therefore, we respectfully request that the definition of "loan" include the proceeds from disposition or restructuring of a loan.

(iii) CLOs and certain other securitizations of loans may include derivatives other than interest rate or foreign exchange derivatives. Since the loan securitization exemption is intended to permit securitizations of loans, we respectfully request that the Agencies revise the exemption to permit any derivatives structured as part of the securitization of loans, not just interest rate or foreign exchange derivatives.

(iv) Certain structures allow for the securitization of credit-linked notes. Credit-linked notes allow banking entities to transfer credit risk of an underlying asset. Such securitizations should be permitted by the Securitization Authorization.

(v) With respect to the Agencies' request for comment (question 301) as to whether additional guidance should be given with respect to securitizations with "intermediate steps," such as asset-backed commercial paper ("**ABCP**") conduit transactions, we believe that, for purposes of the final rule, these types of transactions should be viewed as a single loan securitization. The intermediate step occurs solely because of the financing provided by the ABCP conduit and is a mechanism through which the loans in the intermediate step are securitized.

We respectfully request that the final rules be clarified so that these fundamental structural features of loan securitizations are clearly permitted under the loan securitization exemption. Any lack of clarity on the above points could limit or restrict the ability of a banking entity to securitize loans, which would clearly violate the Securitization Authorization. Moreover, as described below in section III.D, banking entities should be allowed to enter into covered transactions with covered funds that are exempt pursuant to the loan securitization exemption; otherwise the regulation would limit and restrict the ability of banking entities to sell or securitize loans in contravention of the statute.

We respectfully suggest that, in order for the Agencies to avoid violating the Securitization Authorization, the definition of "loan" be expanded to include ABS (loan securitizations and asset-backed securitizations are collectively referred to herein as "**ABS covered funds**"), bonds, letters of credits, guarantees and any other type of extension of credit which could be related to or ancillary to a securitization or structured product.

D. Allow banking entities to enter into covered transactions with ABS covered funds (re question 316)

If ABS issuers are not expressly excluded from the definition of covered fund, we respectfully request that the Agencies revise the Proposed Rule to clarify that the prohibition on covered transactions (the Section 23A

Provision) not apply to transactions with issuers of securitizations and structured products. A failure to make such a revision would be in violation of the Securitization Authorization because the securitizations of loans which involve covered transactions would not only be restricted or limited, but would effectively be prohibited. We have provided below some relevant examples of ABS structures which involve loans between banking entities and ABS issuers.

(i) *ABCP Conduits*: ABCP conduits provide an important source of funding for, among other things, consumer debt. A restriction on the use of ABCP conduits may have an immediate impact on the cost and availability of consumer credit. ABCP conduits typically contain credit support from the relevant banking entity through a loan facility, letter of credit or guarantee. In addition, the ABCP conduit will include liquidity support from the relevant banking entity through liquidity asset purchase agreements and other means. ABCP conduits cannot function without these structural enhancements. We respectfully request that the final rules clarify that ABCP loan facilities and liquidity support would not be considered covered transactions or would otherwise be exempted from Section 619's prohibition on such transactions.

(ii) *Loan warehouse structures*: Loan warehouse structures are used for multiple purposes.

1. In connection with the structuring of a loan securitization, a sponsoring banking entity will often provide a revolving loan to the CLO issuer during the "warehouse period." During the warehouse period the CLO issuer will accumulate loans until the loan pool is large enough to close a loan securitization. If the Proposed Rule became effective in its current form, most CLOs would not be possible. Given the clear statutory requirement that nothing in the final rule should prevent loan securitizations, the loan securitizations and their related warehouse structures should not be deemed covered transactions.

2. Several banks have established joint ventures with investors where the bank will transfer a pool of loans held by the bank to an SPV and in exchange, take back a loan. The SPV will then sell an interest in a first loss tranche to one or more investors. These transactions allow the bank to reduce exposure in their loan portfolios and are specifically allowed under Section 619 as a loan securitization. However, the loan between the sponsoring bank and the SPV may be considered a covered transaction. The final rule should make it clear that if the loan securitization exemption is available, any lending to the loan securitization vehicle would not be considered a covered transaction for purposes of Section 619's prohibition or would otherwise be exempted.

(iii) *Loans to Intermediate SPVs*: In connection with certain securitization structures where assets are transferred to a funding SPV or depositor and then transferred to the issuing SPV, the originator or sponsor will either (i) provide a loan or (ii) contribute capital to the funding SPV in order to pay for any unsecuritized portion of the transaction. These structures are prevalent in transactions with revolving asset pools. Loans or contributions of capital to intermediate SPVs are an unavoidable structural feature of many securitization structures. In some structures, contributions may not be permitted because of certain bankruptcy considerations. In certain circumstances, these intermediate SPVs will be exempt from registration pursuant to section 3(c)(1) or 3(c)(7) of the Investment Company Act (a "**3(c)(7) Entity**"). We respectfully request that the final rules clarify that loans or contributions of capital to such intermediate SPVs would not be considered a covered transaction for purposes of Section 619's prohibition or would otherwise be exempted.

E. The Risk Retention Exception Should be Broadened

The **"risk retention exception"** contained in section _.14(a)(2)(iii) should be broadened to include any risk retention that is required by any law or regulation applicable to either the banking entity or any potential investors, and further to allow banking entities to retain risk in an amount that is greater than the required minimum amount. We note that the EU has adopted risk retention requirements (framed as an investor restriction) for EU regulated credit institutions and is in the process of adopting similar requirements for other types of EU regulated investors. Such EU requirements differ in a number of important respects from the U.S. proposals. At present, retention arrangements structured to achieve compliance under these EU regimes would not benefit from the risk retention exception. If the risk retention exception is not expanded as described above, the final rules could operate such that (EU and other) banking entities seeking to comply with the EU retention requirements (i.e., to ensure that relevant deals could be placed with certain EU regulated investors) would be restricted from retaining an interest in accordance with the EU requirements. In principle, this outcome is not justified and it is not clear from a policy perspective why retention in accordance with the U.S. requirements only would be permitted. Additionally, we believe that the Agencies should recognize that in certain structures for securitizations or structured products, a sponsor may retain more of the ABS or ownership interest in the issuer than the proposed 5% risk retention and this should not present issues under Section 619. We respectfully request that the risk retention exception be revised to permit the retention of an uncapped portion of the risk; otherwise the regulation would limit and restrict the ability of banking entities to sell or securitize loans, which would contravene the Securitization Authorization.

F. Issues relating to Servicers, Custodians and Trustees

(i) *Servicers, Trustees and Custodians should not be included as sponsors, investment advisers or investment managers of covered funds (re question 219).* We respectfully request that the final rules clarify that servicers, custodians and indenture trustees that are banking entities will be excluded from the definitions of sponsors. The Agencies note in the Preamble that the definition of "sponsor" focuses on the "ability to control the decision-making and operational functions of the fund."

The role of a servicer in an ABS transaction generally includes (i) the collection of payments on the underlying assets and (ii) the investment of cash in eligible investments. Such role is typically clearly defined in the relevant transaction documents and the ability of the servicer to vary its actions from those set out in the transaction documents is limited. As a result, the servicer's actions do not give it the level of control contemplated by the Agencies in defining a "sponsor" of a covered fund and therefore a servicer should not be viewed as a sponsor, investment adviser or investment manager of a covered fund solely as a result of it acting in such a capacity.

Similarly, the right of a trustee to control the decision-making and operational functions of a covered fund under the indenture that appoints it is usually extremely limited. The same holds true for a custodian with which certain assets of an ABS issuer are held. Although the securitization documents may authorize or require the trustee or custodian to invest funds held in the trust or custodial accounts, the securitization documents will set out parameters within which such investments must be made and the trustee or custodian would not typically exercise the investment discretion that would rise to the level of a sponsor, investment adviser or investment manager. The Agencies should ensure that final rules are clear that these types of activities of a trustee or custodian would not cause it to be a sponsor of a covered fund.

In a small number of circumstances, servicers and trustees will be granted limited discretion to act in respect of a covered fund or the collateral it holds. For example, in the case of a trustee, the trustee may conduct sales of collateral following a default under the securitization; in the case of a servicer, subject to the relevant servicing standard required of it, the servicer may undertake loss mitigation activities and the liquidation of underlying assets after default on those assets. However, even in these circumstances, these entities do not exercise the level of management and control over a covered fund that the manager of a hedge fund or private equity fund (as those terms are generally understood) has over the activities of its fund.

(ii) *Servicers and Custodians should be explicitly excluded from the Section 23A Provision.* We respectfully request that the final rules clarify that servicing activities as typically provided for in ABS transactions (including servicer advances) would not be considered covered transactions or would otherwise be exempted from Section 619's prohibition on such transactions.

In addition to servicing activities, in certain circumstances other securitization participants may, under the terms of their appointment, enter into transactions with the covered fund that could fall within the covered transaction definition. For example, (as discussed further in footnote 10), if a temporary overdraft in a custodial account is caused by a temporary mismatch of purchases and sales, the custodian will fund such shortfall for a brief period of time. A limitation on the ability of a custodian to extend credit to cover temporary shortfalls would be particularly onerous in jurisdictions with limited custodial services, such as in the emerging markets. To restrict a foreign bank from hiring an affiliate as a custodian in markets where few custodians exist would severely impact the ability to execute transactions in emerging markets and would do nothing to reduce risk to U.S. taxpayers. The final rules should provide a clear exemption for such transactions.

G. The impact on Covered Bond Structures

As currently drafted, the Proposed Rule may interfere with and restrict non-U.S. banks' ability to establish and issue under covered bond structures in a manner that does not reflect the legislative intention behind Section 619 of the DFA and that may, in some cases, prevent non-U.S. banks from accessing financing that is expressly permitted in their home jurisdictions. Restricting these activities would not further the legislative purpose of the Volcker Rule as these activities do not give banks excessive financial exposure to private equity funds and hedge funds engaged in trading and other investment activities deemed to be speculative.

For example, French law covered bonds issued by a société de crédit foncier ("SCF") and collateralized entirely by ECA loans may be impacted by the broad reach of the Proposed Rule. The SCF covered bond issuer holding a revolving pool of loans would need to rely on an exemption from the Investment Company Act based on either section 3(c)(1) or 3(c)(7) thereof. As a result, the sponsoring banking entity will not be allowed to lend money to the covered fund – something that is at the heart of a French covered bond structure. We are left with the remarkable result that a U.S. regulation attempts to prevent a French bank in Paris from entering into a French law covered bond.

Similarly, UK covered bonds, which are issued by banks under a UK legislative framework, are collateralized by revolving pools of assets that are held by a special purpose entity that guarantees the issuing bank's obligations under the covered bonds (with such guarantee secured by the asset pool). The guarantor entity is typically a subsidiary of, and shares a name with, the issuing bank. Given the wide definition of "covered fund" and the foreign equivalency provisions discussed above (and in particular in the context of discussions separate from the Volcker Rule about the continued existence of the exemption set out in section 3(c)(5) of the Investment Company Act, which is currently relied upon in many covered bond structures), it is not sufficiently clear that the Proposed Rule would not have the effect of restricting aspects of the UK covered bond structure (such aspects being, in certain cases, required under UK legislation regulating such structure).

There are numerous covered bond structures in various jurisdictions where the issuing or guaranteeing entities are or could be 3(c)(7) Entities and would have similar issues to the French and UK covered bond structures, both within the EU (e.g. The Netherlands and Italy) and elsewhere (e.g. Canada, Australia and New Zealand). We believe that Section 619 was not intended to capture the activities of non-U.S. banks in issuing covered bonds, which are in many cases issued under the legislative frameworks of such banks' home jurisdiction. We urge the Agencies to make clear that covered bonds, which have been and continue to be an essential source of funding for banks during the financial crisis, are not subject to the prohibitions and limitations of the Volcker Rule.

H. The impact on Repack Vehicles

Repackaging is a service that banking entities provide to their customers involving the transfer of assets to a special purpose vehicle (a "**Repack Vehicle**") that issues securities. A Repack Vehicle typically uses derivatives to customize noteholders' exposure to the underlying assets. Repack Vehicles can play a vital role in the capital markets by allowing existing securities and other financial assets to be restructured to maximize value and improve liquidity. Repack Vehicles generally rely on the exemptions contained in section 3(c)(1) or 3(c)(7) of the Investment Company Act because they often fall outside of the narrow exemption provided by Rule 3a-7 under the Investment Company Act.[21] As a result, Repack Vehicles will fall within the definition of "covered fund" contained in Section _.10(b)(1) of the Proposed Rule. As discussed in Section I, even those Repack Vehicles that are not sold to U.S. persons may be considered covered funds.

(i) *Repack Vehicles should not be deemed to be "covered funds."* Treating Repack Vehicles as "covered funds" and subjecting them to the Volcker Rule would severely undermine banking entities' ability to provide repackaging services to their clients. As we discussed in Section III.B above, the definition of "covered funds" should be limited to traditional understanding of the terms "hedge funds" and "private equity funds."

(ii) *Repack Vehicles do not possess the attributes of traditional hedge funds or private equity funds.* Unlike hedge funds where a manager earns an allocation of profit based on fund performance, most Repack Vehicles have a "static" pool without a manager. Typical Repack Vehicles do not employ a trading strategy or use leverage.

(iii) *Repack Vehicles do not pose the types of risks that the Volcker Rule was intended to address.* Following the advice in the FSOC study, the Agencies should be focused on those covered funds that (i) banking entities feel an obligation to bail out and (ii) allow banking entities to engage in complex risk-taking through investment in such funds. Banking entities that establish Repack Vehicles typically have little incentive to bail them out. The customers of the banking entities often request the investment risk evidenced by the repack securities which results in little incentive for the banking entity to bail the customer out of a bad investment decision.

(iv) *Repackaging is a customer-facilitation activity.* By providing customized risk exposure to the underlying assets, Repack Vehicles provide greater alignment with a client's risk and investment profile. In the Proposed Rule, the Agencies expressly recognize the importance of the provision of client-oriented financial services by banking entities and request comment on the impact of

[21] Repack Vehicles frequently do not satisfy the requirements of Rule 3a-7 for a number of reasons, including: (i) they do not have a U.S. trustee, (ii) they provide for the optional redemption of securities, or (iii) the underlying assets not being eligible assets under Rule 3a-7.

the Proposed Rule on the ability of the banking entities to continue to provide necessary customer related services. If the Proposed Rule is implemented as currently drafted, banking entities will be severely restricted in their ability to provide customized financial structures requested by their customers. It is expected that the impact of the Proposed Rule will be to restrict the ability of bank customers to obtain risk hedging strategies from banks and that bank customers will begin to rely heavily on unregulated finance firms.

(v) *Preserving banking entities' role as financial intermediaries.* Congress recognized that banking entities provide a vital role as financial intermediaries. The basic operation of commercial banks is to act as intermediary between customers. The Proposed Rule risks severely restricting the ability of banking entities to establish Repack Vehicles and to carry out this essential role.

We would be pleased to provide further information or assistance at the request of the Agencies or their staffs. Please do not hesitate to contact Lawton Camp, (212) 610-6309, Chris Salter, (202) 683-3851, or Doug Landy, (212) 610-6405, at Allen & Overy LLP if you should have any questions with regard to the foregoing.

Respectfully submitted,

Allen + Overy LLP

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Canadian Imperial Bank of Commerce

Deutsche Bank AG

HSBC Global Asset Management

Royal Bank of Canada

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