Shareholder Advocacy Forum Comments Re: Amendments to Volcker Rule

April 1, 2020 {Comments Due: April 1, 2020}

VIA ELECTRONIC SUBMISSION

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

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

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

Chief Counsel's Office
Office of the Comptroller of the Currency
400 7th Street, SW Suite 3E-218
Washington, D.C. 20219
Docket ID OCC-2020-0002

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090
File No. S7-02-20

Re: Proposed Revisions to Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds" [Release no. BHCA-8; File no. S7-02-20]

Ladies and Gentlemen of the Agencies:

The Shareholder Advocacy Forum ("SAF") is a nonprofit, nonpartisan organization dedicated to preserving the long-term interests of all shareholders. We are affiliated with Americans for Tax Reform, also a nonprofit, nonpartisan organization focused on lower taxes and limited government. We appreciate the opportunity to comment on pending SEC proposals.

On January 30, 2020 the SEC proposed amendments to the "covered fund" provision of the Volcker Rule. The amendments were jointly developed by five federal regulatory agencies: the Securities and Exchange Commission, Federal Reserve Board, Commodity Futures Trading Commission, and Federal Deposit Insurance Corporation (collectively, the "Agencies").

We commend the Agencies for their efforts to provide clarity to the Volcker Rule, which has been a source of ambiguity and confusion since its adoption in 2013. The proposed rules will better

achieve SEC goals of protecting investors and facilitating capital formation while removing burdens on the use of covered funds. We appreciate the opportunity to provide comments, and we urge the SEC to adopt to the proposal.

History of the Volcker Rule

Dating back to the aftermath of the 2008 financial crisis – the Volcker Rule bears the name of economist and Federal Reserve Chairman, Paul Volcker. Enacted as Section 619[1] of the Dodd-Frank Act and now codified as Section 13 of the Bank Holding Company Act of 1956, Volcker was promulgated as a response to proprietary trading by commercial banks. Under Volcker, commercial banks are prohibited from engaging in proprietary trading using their own accounts and owning or investing in hedge funds and private equity funds. Congress approved the Volcker Rule in 2010, with implementation delayed until 2013. In practice, implementation has proven difficult and the rule is widely unpopular in the financial services industry. The proprietary trading restriction covers purchase or sale, as principal, of financial instruments by a banking entity for one of its trading accounts.

In 2019, the Responsible Agencies adopted several amendments to the Volcker Rule intended to narrow and streamline compliance with the proprietary trading restrictions. The amendments were effective January 1, 2020 and must be implemented by January 1, 2021. The goal was not to stop prohibiting proprietary trading or to increase exemptions, rather, it was to provide clarity as to what the original 2013 rule meant to allow and disallow. The 2019 amendments also made a few minor changes to the covered funds provision pertaining to banking entities acquiring or retaining ownership interest in certain covered funds used for risk-mitigation, market making and underwriting, or if the interest is solely outside of the U.S. In particular, the 2019 amendments hinted at the impending release of a separate proposal specifically relating to the covered funds provision, which is now embodied in the 2020 proposal.

Covered Funds Provision

The Volcker Rule definition of "covered fund" is difficult to textually navigate. The provision defines a covered fund as an entity that (i) relies on section 3(c)(1) or 3(c)(7) of the Investment Company Act; (ii) is a commodity pool whose operator relies on CFTC Rule 4.7 (and similar pools); or (iii) a foreign fund that either relies on 3(c)(1) or 3(c)(7) with respect to US investors or satisfies other criteria.[2] In general, a covered fund under the rule can be said to be a fund that is not considered an *investment company* in the Investment Company Act of 1940. This includes private equity and hedge funds, certain commodity pools, and funds sponsored by a US banking entity where the affiliate holds ownership interest.

The ambiguity in language, however, clearly evidences legislative intent to bring private equity and hedge funds into the purview of Volcker. As a consequence, many investment vehicles that have little or nothing to do with a banking entity's use of speculative trading fall under the broad and inarticulate definition. Additionally, there is an extensive list of exclusions that remove certain

[1] *See* https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf
[2] *See* John Crabb, *PRIMER: the Volcker Rule – Covered Funds* (January 08, 2020), https://www.iflr.com/Article/3817098/PRIMER-the-Volcker-Rulecovered-funds.html

funds from the definition, which has been a regulatory nightmare and a skilled lawyer's best-case scenario. The rule was promoted as addressing a particular issue: speculative practices from banks that led to the 2008 financial crisis. In implementation – compliance has been disastrous, loopholes have been abused, and uncertainty has increased throughout the industry.

There is much contention regarding the legalistic nature of the covered funds definition, with some opponents urging the Agencies to chance the language itself in an effort to limit interpretative issues and ease the burden on foreign entities.

The proposed amendments are a welcomed step towards achieving clarity and consistency in the application of Volcker. SEC Commissioners Hester Peirce and Elad Roisman issues a joint statement on the proposed amendments, expressing their support for the proposal:

> *"This proposal seeks to better tailor the aspects of the Volcker Rule covered fund regulations that have been most disruptive to legitimate and beneficial business activities by banks—activities not even tenuously responsible for the financial crisis that led to the conception of this rule […] The proposal is an important step in recalibrating the rule."*[3]

While some advocate for a complete repeal of Volcker, Commissioners Peirce and Roisman recognize the legitimate legislative mandate, and have opted to endorse the surgical and careful approach found in the proposed amendments. It is not merely "big banks" that are affected by the Volcker Rule's prohibitions – a misconception often touted by advocates for overbearing regulations – many regional banks (particularly those under the $50 billion threshold referenced in Dodd-Frank) have also been subjected to unfair regulations. Commissioners Peirce and Roisman addressed this concern in their public statement as follows:

> *"This is not a good result for those banks and their clients, who have lost the benefits of making investments together; but also for those businesses, who lost this capital raising opportunity."*[4]

The 2020 proposed amendments are a step in the right direction towards limiting the unintentional and economically stunting restrictions contained in Volcker.

Key Provisions of the Proposed Amendments

The joint agency proposal has three articulated goals. First, streamline the covered funds portion of the rule. Second, address the treatment of certain foreign funds. Third, permit banking entities to offer financial services and engage in other permissible activities that do not raise concerns that Volcker was intended to address.[5]

[3] *See* Statement on Proposed Amendments to the Volcker Rule "Covered Fund" Provisions (January 30, 2020), https://www.sec.gov/news/public-statement/roisman-peirce-volcker-rule-2020-01-30
[4] Ibid.
[5] *See* Agencies Propose Changes to Modify "Covered Funds" Restrictions of Volcker Rule https://www.sec.gov/news/press-release/2020-24

A. Streamlining Covered Funds

The proposal would exclude credit funds, venture capital funds, family wealth management vehicles, and customer facilitation funds from the statutory definition of covered fund. The addition of these exclusions is tied to the overinclusive nature of the current definition, while imposing reasonable conditions that safeguard against the exclusions being taken advantage of. The 2013 rule intentionally opted for a broad definition of "covered fund" in an effort to prevent an any loopholes in the proprietary trading prohibition. Instead, banking activity that is not tied to the policy justifications for the rule has been rendered impermissible.

SAF applauds the Agencies for continuing to undertake the task to clarify and streamline the troublesome provisions in the Volcker Rule. The proposed amendments are a welcomed move in the right direction.

B. Foreign Funds

The proposal provides clarity for two issues for qualifying foreign funds. First, it simplifies the requirements to qualify as a foreign public fund to obtain an exclusion from the definition of covered funds.

Currently, a foreign fund is excluded if it is offered in the fund's home jurisdiction and is sold predominately through public offerings outside the U.S. Generally speaking, the fund must be considered an equivalent to a U.S. registered investment company by satisfying several conditions; however, the fund does not currently receive treatment consistent with those analogous U.S. funds. The proposed rule attempts to align the foreign fund exclusion with the exclusion for U.S. registered investment companies. The amendment would allow foreign funds to qualify for the exclusion if ownership interests are offered through one or more public offerings that are subject to substantive disclosure and retail investor protection laws.

Second, the proposal would exempt all qualifying foreign funds from Volcker rule prohibitions. The Agencies have issued no-action relief to such finds since the initial adoption of the rule in an attempt to avoid the imperfection of an extraterritorial application. The proposed amendments would merely codify a common regulatory practice. The 2013 rule already excludes foreign excluded funds; however, foreign funds affiliated with or controlled by a banking entity do not receive the same treatment. SAF strongly supports this portion of the amendment, as it will ease compliance and administration burdens and promote consistent treatment of qualifying funds.

C. Focusing the Rule

The current formulation of the Volcker Rule has broad overreach beyond the proffered justifications. In particular, the rule has operated in direct contrast to the SEC's mission to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation. Volcker has led to a prohibition on banking entities engaging in certain activities that were not to blame for the market crisis that spurred the rule in the first place. Restrictions on such activities – those without

evidence supporting a need for regulations – do not protect investors, and instead discourage market efficiency, and hinder capital formation.

Requested Comments on Venture Capital Funds Exemptions

Commissioners Peirce and Roisman explicitly requested comment on the proposed exemption for venture capital funds. In fact, venture capital funds were never intended to be limited by Volcker restrictions, as such activity does not present the dangers that Volcker was aimed at preventing. SAF strongly disagrees with venture capital funds being included in the "covered funds" definition and we support an exclusion. A focused and functional exclusion will allow banking entities to invest in these long-term growth vehicles that are beneficial to both the entities and customers.

Some Volcker proponents have suggested additional conditions before the exemption can be relied on. The Shareholder Advocacy Forum does not support additional conditions, as they would undercut the usefulness of the exemption – which was proposed in an effort to promote banking entities' ability to fund growing businesses. In response to *Question 44* in the release, SAF recommends not imposing a revenue limit as a requirement of the exclusion. There is no link between fund revenue and bona fide status.

SEC Chairman Jay Clayton articulated a vital link between the Commissions goals and the exclusion for venture capital funds:

> *"Particularly important to me, the proposal could allow banking entities with a presence in and knowledge of the areas where venture capital and other types of financing are less readily available—i.e., "between the coasts"—to provide critical financing to businesses in those areas, as they have traditionally done."*[6]

Banking entities are traditional pillars of financing. The Volcker Rule should not have led to restrictions on primary financial functions, especially those that did not lead to the desire for the rule in the first place. Chairman Clayton goes on to reference the 2019 annual report from the Office of the Advocate for Small Business Capital Formation that connected venture capital funding to community prosperity:

> *"[A]n increase in venture capital funding of 10% is associated with a 2.6% increase in the number of small employers, a 2.9% increase in employment by small employers, and a 3.9% increase in total payroll."*[7]

The amendments relating to venture capital funds are arguably some of the most important information contained in the release. The Agencies should not gloss over the very real benefits that venture capital funds provide to small business and emerging companies, and the need to encourage the availability of such funding through amending Volcker.

[6] *See* Statement on Proposed Amendments to the Volcker Rule https://www.sec.gov/news/public-statement/clayton-volcker-rule-2020-01-30

[7] Ibid.

Conclusion

We applaud the SEC for its work to protect investors and promote market efficiency, and we thank the Agencies for the opportunity to provide feedback on proposed rulemaking measures. The Shareholder Advocacy strongly urges the Agencies to adopt the proposed amendments to the Volcker Rule.

If you should have any questions or comments, please contact James Setterlund by phone at or email at jsetterlund@shareholderadvocacyforum.org or .

Sincerely,

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Shareholder Advocacy Forum