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Invested in America

October 9, 2014

Scott Alvarez
General Counsel
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Extension of Volcker Rule Conformance Period for Certain Categories of Fund Activities and Investments Impacted by the Volcker Rule

Dear Mr. Alvarez:

SIFMA[1] writes to provide the Federal Reserve staff with preliminary data on the categories of covered fund activities and investments for which SIFMA members expect to submit requests for a one-year extension of the conformance period under the final rules implementing section 13 of the Bank Holding Company Act (the "**BHC Act**"), commonly referred to as the Volcker Rule. Our members are taking their responsibility to conform their activities and investments to the requirements of the Volcker Rule seriously and are diligently working to conform their activities and investments by July 21, 2015. Nevertheless certain categories of covered fund activities and investments pose major challenges to realization of this effort.

We have heard from many of our members that there is a material difference between ensuring that new fund activities and investments comply with the Volcker Rule, and the relatively more challenging and complex task of conforming existing fund activities and investments with the regulation. This difficulty is particularly pronounced for legacy interests in funds created before the enactment of the Volcker Rule and in areas where there are open interpretative issues with respect to whether the Volcker Rule imposes restrictions on otherwise permissible activities or investments. In light of the number and magnitude of positions held by our members for which compliance would represent a daunting challenge, the limited interpretative guidance issued to date from the rulewriting agencies on many issues key to the scoping of compliance with the covered fund requirements of the Volcker Rule, and the substantial number of extension requests that the Federal Reserve Staff would be required to examine on a tight time-frame, we suggest that the Board should consider providing extensions by fund type or category, as soon as possible, as a way to help alleviate these burdens and to

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

enable banking entities to more effectively bring their activities and investments into compliance in a safe and sound manner.

In an effort to illustrate the scope of the challenges faced by many banking entities in complying with all of the requirements of the Volcker Rule by the current conformance date of July 21, 2015, and to assist the Federal Reserve staff in explaining these issues to the Board, we have surveyed our members for data on the approximate number of funds in certain categories for which they expect to submit requests for an extension of the conformance period due to open interpretative questions or practical obstacles to conformance. We realize that numbers of funds do not reveal assets under management or market valuations, but we believe, even so, that this data serves as a proxy for scope.

We believe that the data summarized below substantially underestimates the number and magnitude of extension requests that the Federal Reserve staff is likely to receive during the fourth quarter in advance of the January 2015 submission deadline contained in the Board's final conformance rule. The data for the categories of funds activities and investments provided in this letter reflects a sample from only 19 of our members. These and other members have informed us that their analyses are ongoing and it is expected that the numbers cited below will only increase.

The data we have received from our members indicate that they will find it necessary to seek a one-year extension of the conformance period for a large number of funds for the following categories of fund activities and investments.

Bridging the Gap for Illiquid Funds. We appreciate the time you and your staff have taken to meet with us to discuss possible revisions to the illiquid funds provision of the Federal Reserve's final conformance rule. As we have discussed, ownership interests in illiquid private equity funds, whether sponsored or third-party, are among our members' biggest concerns. As envisioned by the statutory text, the extended transition period for these funds would allow for a stable run-off of illiquid interests through 2022 for certain qualifying illiquid funds. Unfortunately, the mismatch between the time of the issuance of the Federal Reserve's final conformance rule in October 2011 and the final Volcker Rule regulations in December 2013 has created a situation where very few, if any, illiquid funds captured by the original Congressional intent are covered by the Federal Reserve's final conformance rule. Our members are at a loss as to how to proceed in the absence of further guidance from the Federal Reserve staff. As we have discussed over the summer, it would be our hope that the final conformance rule would be modified to align more closely to the statutory intent and the final regulations. In the meantime, those illiquid funds that ought to qualify for the extended run-off until 2022 need a mechanism to bridge the gap for the two one-year extensions that would be needed in the absence of either guidance or a rule change.

Based on the data we have received from our members, this category represents a large number of funds for which extensions will be sought. For this category, 14 members responded

and reported an aggregate total of approximately 2965 funds for which they expect to seek extensions.[2]

Time to Bring Funds into Compliance with the Asset Management Exemption. Our members have also informed us that they expect to submit requests for an extension of the conformance period to bring covered funds that they have sponsored into compliance with the asset management exemption. Many members will request an extension of time to sell down or otherwise conform their or their employees' ownership interests in these funds to applicable investment limitations. Providing additional time to do so in a deliberate and gradual way is likely to be in the best interests of other investors in these funds, and potentially investors in the underlying interests. In addition, many members expect to submit an extension request in order to have sufficient time to rename funds or families of funds to comply with the name-sharing restrictions. Renaming is a particularly acute concern where the banking entity no longer has effective business control over the fund or advisor and, therefore, may require significant additional time in order to accomplish this task, which may, in some instances, include seeking the consent of some or all investors in the fund. For example, the authority to change the name of certain funds may be held by an independent entity, in which case written resolution is required by special resolution of shareholders, with involvement by outside counsel and requiring regulatory approvals in the local jurisdiction(s), such as the United Kingdom.

For this category, 8 members responded and reported an aggregate total of approximately 1531 funds for which they expect to seek extensions of the conformance period.

Wind-Down and Late Stage Funds. We understand that our members anticipate filing extension requests for a number of covered funds where the period the funds make investments has expired and which are into their late stages or wind-down. With respect to these funds, banking entities typically made their existing investments or entered into a sponsorship relationship with the fund with the expectation by the banking entities and other unaffiliated investors that they would hold their interests in, or provide services to, the fund until the end of the fund's life. In many cases, investors specifically made investments in these funds in order to share in the advice or other services the banking entity provides to the fund. Permitting banking entities to retain their investments in and relationships with these funds for this additional late stage or wind-down period of time would allow banking entities to meet their pre-existing contractual or other obligations to other investors, which, for the vast majority of sponsored funds, will include fiduciary obligations.

For this category, 9 members responded and reported an aggregate total of approximately 754 funds for which they expect to seek extensions.

Foreign Funds. We plan to send the Federal Reserve a separate letter raising our very significant concerns with respect to banking entity investments in foreign public funds and

[2] Note that this number includes illiquid hedge fund interests that may have suspended redemptions (gated, etc.) or audit holdbacks or that have distributed interests in a separate SPV that holds the illiquid investments (in many cases, transfers on the secondary market are not permitted by such issuers, even if a buyer can be found).

foreign banking entity investments in foreign non-covered funds. As we will detail in our forthcoming letter, we request a one-year extension of the conformance period for investments in and relationships with all foreign funds (including foreign public funds, foreign non-covered funds and SOTUS funds), given the complexity of issues, interpretive uncertainties and unintended extraterritorial impact on offshore fund markets.

For the purposes of this letter, we thought it would be helpful to let you know that, in addition to the facts provided in the Institute of International Bankers' ("**IIB**") submission dated September 12, 2014 regarding foreign banking entities, 3 members who are U.S. headquartered banking entities (and whose data therefore is not included in the IIB's submission) have informed us that they intend to seek extensions for approximately 1202 foreign public funds. Five members who are non-U.S. headquartered banking entities have informed us that they intend to seek extensions on an aggregate total of approximately 2735 foreign public funds. With respect to foreign funds, 4 members who are non-U.S. headquartered banking entities have informed us that they intend to seek extensions for approximately 2095 funds that may or may not fall within either the excluded foreign fund exemption or the SOTUS exemption depending on interpretative guidance.

Legacy Registered Investment Companies ("RICs") and Foreign Public Funds. Asset managers commonly seed RICs and foreign public funds for a period of time. A number of variables impact the time it takes to launch a fund and raise sufficient assets. For example, Morningstar, a mutual fund rating agency, will only rate funds with at least a three-year track record. Many distribution platforms require a fund to have a Morningstar rating and/or a three-year track record before it may be included on a platform; many consultants or fund selectors have policies against recommending or investing in funds without a Morningstar rating and/or less than a three-year track record.

Several members have legacy seed investments in open-end RICs (mutual funds) or foreign public funds for which they serve as investment advisor that represent more than 24.9% of the voting securities of the RIC (or more than 14.9% of the foreign public fund). Such funds may be deemed banking entities and, as such, subject to the Volcker Rule's proprietary trading and funds restrictions. These funds are important from a business strategy perspective. Additionally, in some cases, these funds have a limited number of external investors, who could be harmed by a rapid liquidation of the fund or a substantial positions in it. We request that the Board consider a categorical extension of one year for all existing RICs and foreign public funds to facilitate conformance with the Volcker Rule and enable sponsors to dilute seed capital through external distribution efforts, or to determine whether to divest or file for such additional extensions as may be possible.

In light of the three-year minimum performance history required for funds to be rated by Morningstar and/or included on many distribution platforms, and in order to provide certainty to fund sponsors about their ability to seed a new fund during that time, and so that the Federal Reserve staff does not find itself faced with routine requests for seeding extensions, we recommend that, separate from this request, the Federal Reserve staff adopt a process providing for a presumptive seeding period for non-legacy mutual funds and foreign public funds sufficient

to meet track record expectations, subject to specified criteria. This request is not intended to limit eligibility for extension relief by application for already existing funds that may have planned on longer seeding periods prior to the Volcker Rule.

TOBs and Other Municipal Bond Repackaging Vehicles. Many municipal bond repackaging vehicles, including municipal securities tender option bond ("**TOB**") structures, fall within the definition of a covered fund. Our members retain ownership interests, perform activities (such as acting as liquidity provider or remarketing agent) and/or sponsor such programs. Members who are active in this market have been working collectively to find ways to restructure TOBs and other municipal bond repackaging vehicles to bring them into compliance with the Volcker Rule, as necessary. The solutions will have to be market-wide and acceptable to the agencies, the relevant ratings agencies, those investors who buy the securities and the members who sponsor them. As we understand that staffs of the agencies may not be supportive of the initial solution that many of our members had planned to rely on for conforming their investments in and relationships with TOBs, the industry is working on alternative means of restructuring these programs that currently represent a $70 billion market. Additional time will be needed to develop and implement new structures for this market that comply with applicable rules (including the forthcoming credit risk retention rules, as applicable) and to restructure existing transactions. In light of the significant disruption to the municipal securities markets and the economic burden imposed on municipalities if banking entities were effectively prohibited by the Volcker Rule from participating in TOBs and other municipal bond financings, as acknowledged by the agencies in the supplemental information, we expect that a number of extension requests will be forthcoming. As an example, 9 members responded that they will request extensions for approximately 3004 TOBs structures in the aggregate.

Compliance and Documentation Around Widely Traded Legacy Funds Positions and Secondary Trading. As conformance planning has developed, many of our members have begun to uncover documentation and compliance challenges that will require the development of industry-wide solutions and, in some instances, would benefit from guidance from the agencies. Our members realize that they must document their compliance for investments in covered funds and prove out when an investment in a vehicle benefits from an exclusion or exemption from the covered fund definition or is not an ownership interest. There are many types of funds and other asset pools, created long before the Volcker Rule was adopted, that trade widely in secondary markets for which information is not publicly available that would allow a banking entity to determine covered fund status. In many cases, it is unlikely that the issuance in question will fall within the covered funds definition, but a secondary trading desk lacks the available information necessary to conclusively prove the exemption by July 21, 2015. The situation is even more difficult for thousands of legacy sponsored funds where we understand that the precise Investment Company of 1940 ("**'40 Act**") exemption must be identified, which is something that has not been market practice. Finding, cataloging and analyzing documentation for major asset classes, such as ABS, CMBS, RMBS, CLO, convertible bonds, foreign ETFs or listed investments trusts, ABCP, covered bonds and synthetic structures over the same (*e.g.*, TRS, options, CDS over single-name SPV underliers), going back many years is an Herculean task, with little to no benefit, in light of the fact that these structures are unlikely to be covered funds and are far afield from the policy goals of the Volcker Rule. Based on our experience, references

to specific '40 Act exemptions are not typically contained in disclosure documents of legacy transactions, nor are they typically found in supporting legal opinions. Accordingly, banking entities and their counsel would theoretically need to re-evaluate each transaction to understand what exemption may be relied upon, which would substantially impair the functioning of many of these markets, in which securities are traded frequently, and the portfolios in which many individual securities are traded. We suggest that some practical solutions may be necessary, which will require additional time to think through and develop. To help illustrate, we set forth some examples from the covered bond market, just one of many possible implicated asset classes.

- ***Covered Bonds Example.*** The covered bond market is very large with total outstandings of 2,598,464 million Euro as of December 31, 2013. The issuers of covered bonds are either foreign banks or special purpose vehicles owned by foreign banks and the market largely serves to finance mortgages in Europe. Based on their Volcker Rule compliance planning, our members have determined that many covered bonds are issued by a "foreign bank" under Rule 3a-6 of the Investment Company Act. For example, German Pfandbrief should fall into this category and would not be covered funds. As each country with covered bonds has its own structure, many of the other types of covered bonds, which involve special purpose vehicles, would not be ownership interests as they function as classic senior debt securities and do not trigger any of the factors in the other similar interests categories. The challenge is the documentation and proof of these elements across a wide pool of covered bonds over many countries going back many years. Banks are the primary investors in covered bonds.

Many Other Critical Categories. In addition to the categories listed above, there are a number of other types of funds that require additional time to work through interpretative issues and bring into compliance for which our members have informed us that they will be requesting extensions. These include:

- structured products offered before December 2013, which includes structured products that will have to be de-sponsored or unwound—evaluating whether a vehicle is sponsored can raise difficult interpretive questions and arranging an unwind can be extremely time consuming, given that some of the larger banking entities have hundreds of such vehicles;

- other legacy securitizations that will come to maturity during the extended conformance period;

- certain family pooled vehicles;

- non-exempt employee security companies;

- illiquid hedge fund interests (as opposed to private equity funds) that may have suspended redemption (gated, etc.) or that have distributed interests in a separate SPV that holds the illiquid investments;

- formerly permissible hedges involving ownership interests in covered funds; and

- vehicles or entities used to hold bad-bank assets (*i.e.*, those formed to hold legacy assets and related hedges in connection with winding-up/running off a business or division) or other legacy assets that have been substantially written-down where selling such interests would serve no other purpose than to crystalize the loss on the firm's books and where an earlier sale would result in a greater forfeiture.

The Board, acting either alone or with the other agencies, has several methods by which it might choose to extend the conformance period for funds activities and investments. We suggest that different approaches might be appropriate in light of the varying scope, scale, type and urgency of the issues. For example, the Board might consider the following mix of alternatives:

- In the very near term, a one year extension, by order, for all categories of funds activities and investments identified in this letter.

- In the very near term, a one year extension, by order, for all foreign funds (including foreign public funds, foreign non-covered funds and SOTUS funds), in light of the interpretive uncertainty that is leading to conformance plan scoping issues, the potential impact on foreign markets and multiple requests to so do from different market players.

- In the very near term, a one year extension, by order, for all illiquid private equity funds and other funds for which the Board is likely to eventually revise its conformance rule so as to avoid multiple interim extension requests, with a signal as to what the Board intends for the second year. We would be very grateful if a revised conformance rule proposal would also soon be forthcoming, if for no other reason than to aid our members' conformance planning.

- Consideration of other categories of funds that might be eligible for extensions by type by order. This alternative would be a formal Board action, like the statement on CLOs issued by the Board in April of this year, in which the Board signals its intent to grant additional extensions of the conformance period, or actually grant an additional one-year extension for certain tailored categories of funds.

- The Board could also act to streamline the process for extending the conformance period through a simplified notice style extension process similar to the expedited action for certain nonbanking proposals found in section 225.23 of the Board's Regulation Y.

- Consideration of practical solution for the transition to documentation and scope of proof needed to show that many widely traded legacy funds that are unlikely to fall within the definition of covered funds are, in fact, outside of the scope.

We believe that these alternatives are both workable and practical and will provide banking entities with increased certainty regarding the compliance of their legacy funds with the Volcker Rule and enable them to focus increased resources on their existing good-faith conformance efforts.

Finally, we respectfully request that the Board and its staff issue guidance in this area as soon as practicable. Many of our members are already in the process of preparing extension requests to be submitted during the fourth quarter. Clarity in this area will relieve or otherwise mitigate many of the challenges facing both banking entities and Federal Reserve staff.

* * *

We appreciate your consideration of this letter and stand ready to provide any additional information or assistance that you might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 or Matt Nevins at 212-313-1176.

Sincerely,

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