FINANCIAL SERVICES FORUM

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Invested in America

July 15, 2019

VIA ELECTRONIC SUBMISSION

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Control and Divestiture Proceedings (Federal Reserve Board Docket No. R-1662, RIN 7100-AF 49)

Ladies and Gentlemen:

The Financial Services Forum (the "Forum") and the Securities Industry and Financial Markets Association ("SIFMA" and, together with the Forum, the "Associations")[1] appreciate the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB") on the notice of proposed rulemaking (the "Proposal") regarding the definition of control under the Bank Holding Company Act ("BHC Act") and the Home Owners' Loan Act ("HOLA").[2]

In this letter, we describe how the Proposal can be adjusted to help ensure that U.S. financial markets and banking organizations remain competitive, continue to be well positioned to drive innovation and growth, and are fully able to meet their customers' capital markets and asset management needs. Without the modifications we suggest, U.S. financial markets risk being left behind at a critical time of change, as the global financial services sector transforms how capital and credit are provided to the real economy. Therefore, the Proposal is highly consequential to all member institutions of the Associations. We have focused this letter on priority issues related to innovation in capital and other financial markets, which we long have believed are important policy concerns.[3] We also support the comment letter submitted by the Bank Policy Institute ("BPI"), which discusses a broader range of issues.

[1] For more information about the Associations, please see Appendix A.

[2] Control and Divestiture Proceedings, 84 Fed. Reg. 21634 (May 14, 2019).

[3] *See* SIFMA, Rebalancing the Financial Regulatory Landscape at 130-133 (May 1, 2017) (recommending, in a white paper to the Treasury Department regarding its "core principles" reports, that the FRB modify its interpretation of "control" under the BHC Act to ensure it

Executive Summary

We support the FRB’s goal to provide greater clarity regarding the controlling influence test. Aspects of the Proposal, however, should be modified to avoid unnecessarily impeding growth and innovation.

- **The Proposal should be revised to facilitate investments in emerging companies and technologies.** First, the FRB should provide additional flexibility for a banking organization to have business relationships with companies, particularly emerging companies, in which the banking organization invests. As proposed, the controlling influence test would make it impractical for banking organizations to partner with fintech firms, unnecessarily restraining innovation in the financial sector. Second, the Proposal should allow investors to utilize typical minority protection rights to ensure the soundness of their investments. Third, the proposed calculation of total equity is inappropriate in a number of respects for investments in emerging companies and other startups. As a general matter, the standards for calculating total equity should be modified to better reflect an investor’s economic stake in a company. In addition, the “functionally equivalent to equity” test should be eliminated because it does not accord with the Proposal’s goal of clarifying the FRB’s framework for evaluating control and, therefore, would inject deleterious uncertainty into transactions. Further, the total equity recalculation requirement similarly would chill investment because investors could be presumed to control based on third-party actions or their own sales of equity and also should be adjusted.

- **The Proposal should be revised to facilitate customer-driven capital markets and asset management transactions and businesses.** First, the FRB should add a presumption of non-control for financing vehicles whose only function is to hold a specified pool of assets (or assets that meet specified criteria). Treating these entities as subsidiaries would cause unnecessary compliance obligations, given that these entities effectively have no management or policies to control (i.e., there is limited policy benefit in treating them as controlled). Second, the Proposal’s presumption of control for entities subject to consolidation under U.S. generally accepted accounting principles (“GAAP”) should be eliminated because it needlessly would increase the cost of offering various financing products to customers and could forestall innovation; at minimum, variable interest entities (“VIEs”) should be exempted from this presumption. Third, the investment fund presumptions should be revised to avoid impeding the formation of new funds. Specifically, the FRB should revise the presumptions to allow a multi-

does not impede investments in venture capital and fintech companies), https://www.sifma.org/wp-content/uploads/2017/05/SIFMA-EO-White-Paper.pdf.

year seeding period and raise the permitted post-seeding voting equity threshold.

I. Facilitating Investments in Emerging Companies and Technologies

During a time of significant innovation in the financial services sector, and considering the growing trend of financial services being provided by firms outside of the regulatory perimeter, the FRB should ensure that its control standards facilitate the ability of banking organizations to invest in emerging companies and technologies and, therefore, remain competitive and contribute to innovation in financial services. Relatedly, the FRB should avoid disturbing prior investments by clarifying that banking organizations are not expected to review ownership structures and relationships that were existing before the final rule and non-controlling under then-prevailing control standards.[4] Without addressing these points, the FRB risks allowing the U.S. financial sector to fall behind the rest of the world as a leader in innovation.

A. Additional flexibility for business relationships, which are important to emerging companies, is needed.

The FRB should revise the Proposal to provide banking organizations additional flexibility to have business relationships with companies in which the banking organization has an otherwise non-controlling investment. As noted, these types of relationships are critical for partnering with emerging companies. In addition, unlike such factors as governance and voting rights, the existence of business relationships does not provide any legal right to affect, or other form of direct influence over, the *management* or *policies* of a company. Rather, the potential influence is, at best, indirect and speculative.

The FRB currently permits business relationships that are “quantitatively limited and qualitatively nonmaterial.”[5] Recognizing that business relationships are not always a concrete indicator of an investor’s influence over a target company, however, the FRB’s precedents in this respect have “varied significantly based on the facts and circumstances presented.”[6] In an attempt to remove this variation, the Proposal includes a tiered approach to business relationships. For investments of less than

[4] The FRB took a similar approach in promulgating Regulation LL. In the preamble to that final rule, the FRB said that it generally did not “anticipate revisiting ownership structures previously approved by the OTS” but that it would apply the new control rules to new investments and “material transaction[s]” regarding existing investments. 76 Fed. Reg. 56508, 56510 (Sept. 13, 2011).

[5] *See, e.g.*, Federal Reserve Board, Policy statement on equity investments in banks and bank holding companies at 13 (Sept. 22, 2008), http://www.federalreserve.gov/newsevents/press/bcreg/bcreg%2020080922b1.pdf (hereinafter, “2008 Policy Statement”).

[6] 84 Fed. Reg. at 21641.

5% of any class of a company's voting securities, there would be no restrictions on business relationships. Accordingly, bank holding companies could rely on section 4(c)(6) of the BHC Act to make less than 5% investments in, and have business relationships that are not subject to the Proposal's limits with, nonbank companies, provided that the investment is less than one third of total equity, no management agreements are in place, and the GAAP consolidation presumption does not apply.[7] Above the threshold of 5% of any class of voting securities, the Proposal would presume control if the amount of business relationships with the target exceeds a specified percentage of the revenues or expenses of the investor or target.[8]

These business relationship restrictions would be unduly restrictive for relationships that banking organizations seek with fintech and other innovative, early stage companies. In particular, due to the size of such companies and importance of a business relationship with an early investor, it very well may be that the value of having a banking organization invest in such a company is to provide an "anchor" customer that can offer feedback and help improve the company's services as the company matures and broadens its customer base. Those relationships, however, may cause the company to be a subsidiary of the banking organization under the Proposal's standards, thereby making the banking organization responsible for the company's compliance with applicable laws and regulations, including the BHC Act or HOLA, without having the practical ability to ensure compliance. The company also would become subject to the activities restrictions of the BHC Act or HOLA. As a result, the proposed presumptions based on business relationships would be an impediment for banking organizations that wish to invest in emerging companies and technologies.

Because many types of business relationships do not provide an investor the ability to influence the management or policies of the target, we believe changes can be made without undermining the FRB's policy objectives. Indeed, the type of monitoring of revenues and expenses of an emerging company that would be required by the Proposal also may have the perverse effect of requiring the investor to become more involved in the target than ordinary, arms-length business relationships normally would require.

Accordingly, we recommend the following modifications to facilitate investments in emerging companies.

- Considering only revenues of the target. The presumption should be modified to apply the thresholds described below and should consider only the revenues of the target, rather than revenue of the investor or expenses of

[7] On a related point, we support BPI's comment that the final rule should not eliminate the presumption of non-control set forth in section 2(a)(3) of the BHC Act and 12 CFR 225.31(e).

[8] *See* 84 Fed. Reg. at 21658-21659 (to be codified at 12 CFR 225.32(d)(4), (e)(3)(ii), (f)(4)).

either party. This change is appropriate because revenues of the investor and expenses of either party do not provide additional information regarding the ability of the investor to control the target.[9]

- Raising the revenue thresholds. We suggest modifying the thresholds as follows: (1) no restrictions for investments of 9.99% or less of any class of voting securities; (2) 20% of the second company's revenues for investments of 10% to 14.99% of any class of voting securities; and (3) 10% of the second company's revenues for investments of 15% to 24.99% of any class of voting securities.

- Allowing a transition period. The presumptions should be modified to apply only after a three-year transition period, with the possibility for extension in appropriate circumstances, during which business relationships may exceed the specified thresholds. This modification would recognize that relationships with an emerging company might be more extensive at first, but naturally decline as the company grows. Said differently, in many ways, these types of anchor relationships are analogous to investment fund seed investments, which the FRB has recognized are important to facilitate the organization of investment funds.

- Excluding certain types of ordinary course business relationships. If revenues of the investor are maintained as a test, the presumption should be modified to exclude arms-length lending and deposit relationships. Moreover, arms-length vendor, asset management and distribution, and other relationships where comparable relationships are available from third parties in competitive markets and there is no exclusivity arrangement between the investor and the target should be excluded from measuring the revenue of the target. The FRB previously has recognized that arms-length relationships do not pose the same control issues as others.[10] Our

[9] Although the Proposal argues that business relationships that are significant to the investor may create a greater incentive for the investor to attempt to influence the target, incentive is not relevant to the investor's ability to influence the company. *See* 84 Fed. Reg. at 21641. Furthermore, the Proposal does not explain why the FRB considers expenses of either party to be relevant to the exercise of influence over the target and offers no evidence of a correlation between increased expenses and increased influence. Indeed, the percentage of a target's expenses devoted to an investor is a poor proxy for the ability of that investor to influence the target, as the underlying services may be easily replaced or temporary or the target may have relatively few other expenses.

[10] *See* BOK Financial Corp., 81 Fed. Res. Bull. 1052 (1993) (allowing a minority investor to buy and sell loan participations to a target company without controlling it because of, among other factors, "the independent ability of each company to determine whether to participate in individual loans"); FRB Letter dated May 28, 1996 to Lakeland Bancorp, Inc. (allowing a minority investor to participate in loans with a target company without controlling it because, among other factors, "each participant would be provided adequate credit history and information regarding the borrower, and each party, independently, and

recommendations are consistent with these precedents and are designed to facilitate ordinary course business relationships that do not give rise to a controlling influence.

B. Protective rights that ensure the soundness of minority investment are needed.

Flexibility in the contractual rights that a banking organization may have with respect to a non-controlling investment is needed to facilitate investments in emerging companies and technologies. To have the certainty necessary to make such investments, banking organizations require access to typical minority investor protective rights. These types of rights are designed to ensure that investments are sound and that the diligence and assumptions on which investments were premised will remain accurate. They do not amount to a controlling influence over the management or policies of the company and reaching that result is not their intent. Without access to these types of protections, banking organizations will be inhibited in their ability to partner with companies that are on the forefront of innovation.

Historically, the FRB has maintained that rights allowing investors to direct or block major operational or policy decisions of a target company raise controlling influence concerns.[11] The Proposal attempts to codify this historical position by presuming control where an investor has any "limiting contractual right" for investments of 5% or more of any class of voting securities. The Proposal would define "limiting contractual right" to mean a contractual right that allows an investor to restrict significantly the discretion of the target over its operational or policy decisions.[12] Further, it specifies that various standard debtor-creditor covenants, when combined with ownership of 5% or more of any class of voting securities, would trigger a presumption of control over the borrower.[13] The Proposal also includes a non-exhaustive list of examples of limiting contractual rights, which is expansive and would discourage investment in emerging companies and technologies.[14]

To address the concerns regarding the minority protective rights that we raise above, the FRB should make the following modifications. First, limiting contractual rights should not trigger a presumption of control for investments of less than 10% of any class of voting securities. Second, the FRB should clarify that limiting contractual

based on the information it receives, would make its own credit analysis and decision whether to purchase the participation"). *See also* 2008 Policy Statement at 13 (indicating that business relationships that are made with market terms, non-exclusive, and terminable without penalty are less likely to indicate a controlling influence).

[11] 2008 Policy Statement at 13-14.

[12] *See* 84 Fed. Reg. at 21657 (to be codified at 12 CFR 225.31(e)(5)).

[13] *See* 84 Fed. Reg. at 21652.

[14] *See* 84 Fed. Reg. at 21657-21658 (to be codified at 12 CFR 225.31(e)(5)).

rights do not include rights with respect to: (i) raising additional debt or equity capital; (ii) merging or consolidating, or selling, leasing, transferring, or disposing of material subsidiaries or major assets; (iii) acquiring significant assets or control of another firm; (iv) engaging in new lines of business; (v) matters that are subject to a consent right that can only be exercised collectively by a group of investors, such as a class of preferred stock in which there are multiple investors; or (vi) ensuring regulatory compliance for an investing banking organization. Third, the FRB should allow banking organizations to benefit from typical senior debt covenants without giving rise to a controlling influence over a borrower, as long as those covenants are tied only to a debt investment and not to an equity investment. Without this change, banking organizations will be significantly limited in their capacity to offer debt to companies in which they hold equity. Such dual investments are common practice, particularly when providing financing to emerging companies.

C. The proposed treatment of equity is inappropriate for investments in emerging companies and other startups.

Three changes are necessary to the treatment of equity to facilitate investments in emerging companies and technologies. First, as a general matter, equity ownership should be calculated in a way that focuses on an investor's economic stake in a company rather than accounting abstractions that are unrelated to the investor's economic interest. Second, the "functionally equivalent to equity" test should be eliminated. Third, the equity recalculation requirement should be revised to exclude recalculation based on divestiture of equity securities when an investor has a non-controlling stake at the time of divestiture.

The Proposal presents standards for calculating an investor's total equity ownership in a target company. We support BPI's comment letter regarding this issue, which sets forth a more exhaustive analysis of the flaws inherent in the proposed approach. Moreover, we wish to highlight that these standards are particularly problematic for investors in emerging companies. For instance, it is typical for investors to acquire preferred stock with a liquidation preference in early stage investments. In such a case, the liquidation preference is intended to guard against the inherent downside risk of an investment in an early stage company. Yet, the Proposal would value equity at a liquidation preference despite the fact that such a preference does not reflect the investor's stake upon a sale or IPO of the company (the economics of early stage investments are often based on the "as-converted" value, not the liquidation preference). In addition, the Proposal's standards severely penalize preferred stock investors, and otherwise significantly distort equity ownership percentages, in companies with negative retained earnings, which is likely to be the case for most emerging companies. As a result, our view is that the methodology should be revised to avoid discouraging investments in early stage companies.[15]

The Proposal also would prescribe standards for assessing whether a debt or other non-equity interest is "functionally equivalent" to equity.[16] These standards would chill lending, investment, and ordinary course commercial arrangements because it is unclear under the proposed qualitative test what interests would be treated as equity and how certain interests, such as profit participations, would be valued.

Further, the Proposal would add a requirement that total equity be recalculated each time an investor acquires control over, or ceases to control, equity instruments of a target.[17] By requiring recalculation when an investor ceases to control equity securities of a target, the proposed regulations could cause the investor to be presumed to control the target without taking any action to increase its equity ownership or other indicia of control. For example, a non-pro rata redemption of shares by the target could cause an investor to be presumed to control the target when the investor subsequently sells shares. To avoid this counter-intuitive result (gaining control through a disposition), recalculation should not be required by a non-controlling investor upon a disposition of shares.

II. Facilitating Customer-Driven Capital Markets and Asset Management Transactions and Businesses

The FRB should make three primary changes to facilitate customer-driven capital markets and asset management transactions and businesses. First, the FRB should reduce restrictions on financing structures by adding a presumption of non-control for VIEs, whose only function is to hold a specific pool of assets (or assets that meet specified criteria). Second, the FRB should eliminate the presumption of control over entities consolidated under U.S. GAAP. Third, the FRB should revise the Proposal to avoid impeding fund formation by providing for a multi-year seeding period for all funds and permitting increased ownership and director representation thereafter.

A. GAAP consolidation, and the other presumptions of control, should not restrict common financing structures.

The FRB should include a presumption of non-control for VIEs whose only function is to hold a specified pool of assets (or assets that meet specified criteria). These financing vehicles often do nothing more than hold loans or other underlying assets

[15] Another ownership interest that should not be counted toward an investor's total equity is tax equity, which does not provide economic exposure to a second company (as a typical equity investment would) but rather serves as a method to make a market for tax attributes.

[16] *See* 84 Fed. Reg. at 21660 (to be codified at 12 CFR 225.34(c)).

[17] *See* 84 Fed. Reg. at 21660 (to be codified at 12 CFR 225.34(e)).

on behalf of investors.[18] In many cases, the vehicles are organized as trusts and the trustee and holders of debt and equity have no discretion over the vehicle's actions. The FRB appears to have acknowledged that these entities are of limited supervisory concern, as banking organizations generally are not required to report their interests in such entities as part of their organizational structure.[19] Therefore, treating these entities as controlled would not further the FRB's policy objectives—there are effectively no management or policies to control—but would cause unnecessary burden to banking organizations participating in customer-driven financing structures. This non-control presumption is necessary because it is unclear whether the FRB would consider such vehicles to be bank holding company subsidiaries if the banking organization can name a successor trustee, holds senior debt that could be treated as equity, or holds a residual interest, even if the banking organization has no other rights.[20] An explicit presumption of non-control, as well as treating the right to name a successor trustee in the same manner as similar rights regarding general partners and managing members in the proposed definition of nonvoting security,[21] would eliminate the unnecessary regulatory burden associated not only with treating VIEs as subsidiaries but also with applying the controlling influence analysis to the financing structure VIEs described above. This burden includes treating such entities as affiliates for various purposes including Regulation Y and the Volcker Rule.

In addition to adding a presumption of non-control, for all the same reasons, the FRB should eliminate the presumption of control over entities consolidated under U.S. GAAP. This presumption would capture the same type of vehicles described above. Reliance on a separate organization to set and revise control standards, especially where the underlying objectives of the organization's accounting consolidation rules differ materially from those of the BHC Act,[22] does not appropriately effectuate the

[18] Certain VIEs, such as asset backed commercial paper conduits, take some action regarding the assets they hold. These entities hold assets that meet certain credit or similar quality tests and remove and replace them if they deteriorate in quality. We believe that these entities do not have a sufficiently compelling business purpose to warrant regulation because their actions lack unrestrained discretion in a manner very similar to entirely passive financing vehicles.

[19] *See* Federal Reserve Board, Instructions for Preparation of Report of Changes in Organizational Structure (Form FR Y-10) at NBK-2 (Oct. 2016), https://www.federalreserve.gov/reportforms/forms/FR_Y-1020161014_i.pdf.

[20] Residual interests, in particular, are a small part of the capital structure of securitization vehicles. If residual interests are treated as equity, even if they confer no voting or control rights, a residual interest holder may be deemed to control the vehicle despite ownership of an immaterial economic interest.

[21] *See* 84 Fed. Reg. at 21661 (to be codified at 12 CFR 238.2(r)(2)(iii)).

[22] Financial Accounting Standards Board, Accounting Standards Update 2015-02 at 1 (In formulating its consolidation rules, FASB considered "the objective of general purpose financial reporting, which is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions

FRB's policy goals. As noted, no regulatory purpose appears to be served by treating VIEs as subsidiaries.

Alternatively, if the final rule includes a presumption of control over entities subject to GAAP consolidation, the FRB should make clear that only common equity interests in VIEs are "ownership interests" for intermediate holding company purposes. Regulation YY requires certain foreign banking organizations to hold their entire "ownership interest" in any U.S. "subsidiary" through an intermediate holding company.[23] "Subsidiary" means any company that a foreign banking organization "controls," as defined in Section 2(a) of the BHC Act.[24] Because "ownership interest" is not defined in Regulation YY, the accounting consolidation presumption of control could be interpreted to require foreign banking organizations to hold their variable interests (such as those resulting from providing a liquidity or credit facility to a U.S. VIE) through an intermediate holding company. This result would entail significant tax and restructuring costs. Further, considering the passive nature of VIEs as described above, such costs are not warranted and would be unduly burdensome.

B. The investment fund presumptions of control should be revised to avoid impeding the formation of new funds.

The Proposal should permit a multi-year seeding period for all investment funds. As the Associations have commented previously, banking organizations regularly provide the initial capital necessary to organize various types of investment funds and, indeed, this seed capital is necessary to organize and offer new investment funds that ultimately fulfill the asset management needs of clients.[25] The FRB has recognized that such seed capital is necessary to accommodate customer-driven asset management businesses. As a result, the FRB permits banking organizations to control funds during a multi-year seeding period to allow sufficient time to market them to unaffiliated investors.[26] The Proposal, however, would be more restrictive

about providing resources to the reporting entity."), https://asc.fasb.org/imageRoot/92/63493892.pdf.

[23] *See* 12 CFR 252.153(b)(1).

[24] 12 CFR 252.2(z); 12 USC § 1813(w)(4).

[25] *See, e.g.,* SIFMA, Comment Letter on the Notice of Proposed Rulemaking Revising the 2013 Final Rule Implementing Section 13 of the BHC Act (the Volcker Rule) (Oct. 17, 2018), https://www.sifma.org/wp-content/uploads/2018/10/Notice-of-Proposed-Rulemaking-Revising-the-2013-Final-Rule-Implementing-Section-13-of-the-BHC-Act.pdf; Financial Services Forum, Comment Letter on Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Oct. 17, 2018), https://www.fsforum.com/wp-content/uploads/2018/10/forum-volcker-rule-comment-letter.pdf.

[26] *See* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33432, 33443 ("Recognizing that the length of a seeding period can vary, the staffs provided

than the FRB's precedents and would require divesting to below 5% of any class of the voting securities of an investment fund after a one-year seeding period.[27]

The Proposal's approach could unnecessarily limit asset management businesses, a result which should be avoided for the following reasons. First, a multi-year seeding period and our other recommendations described below would allow banking organizations to meet customer driven asset management needs. Second, and relatedly, investment funds are a natural way to disperse risk while providing capital to a range of industries, including to emerging companies. In some instances, banking organizations have specific expertise that they can offer when advising a fund that makes investments in emerging companies particularly appropriate. For example, a banking organization may have unique expertise in advising a fintech or other financial services-focused fund. Therefore, facilitating the formation of such funds would promote further investment in emerging companies and technologies that bring innovation to the financial services sector. Third, allowing a multi-year seeding period would permit banking organizations to test new investment strategies which may require, due to their novelty, more time to market to unaffiliated investors. Thus, facilitating the formation of such funds would contribute to continued innovation and efficiency in the asset management sector.

i. The FRB should permit increased ownership and director representation for registered investment companies and their foreign equivalents.

The FRB should revise its treatment of registered investment companies ("RICs") under their carve-out from the investment fund presumption of control (the "RIC carve-out") to allow banking organizations to remain competitive in meeting the asset management needs of customers. In particular, along with allowing a multi-year seeding period, the FRB should increase the threshold for ownership of voting equity after the seeding period to 24.9%. The RIC-carve-out also should deem the RIC adviser to be within the director representative threshold as long as the advised fund meets the independence requirements of the Investment Company Act of 1940, as implemented by the Securities and Exchange Commission. Moreover, foreign funds that are equivalent to RICs should likewise benefit from an exception to the presumptions.[28] In addition to supporting customer-driven asset management

an example of three years, the maximum period of time expressly permitted for seeding a covered fund under the 2013 final rule, without setting any maximum prescribed period for a RIC or FPF seeding period.") (emphasis added); Federal Reserve Board, Volcker Rule FAQs 14 and 16 (allowing ownership of more than 25% of a RIC or foreign public fund for a multi-year seeding period without treating the fund as a "banking entity"), https://www.federalreserve.gov/supervisionreg/faq.htm.

[27] Registered investment companies would benefit from a carve-out, which would use the same equity levels and seeding period, but also permit certain other indicia of control, such as customary fund administration and director representatives.

[28] Because foreign equivalent funds may have a different governance structure than RICs, instead of using the director representative threshold, a foreign fund should qualify for the

businesses, this approach would accord with the FRB's precedents. Specifically, the FRB has allowed banking organizations to hold up to 24.9% of any class of voting securities of a RIC or foreign equivalent after a multi-year seeding period.[29] This approach recognizes that the purpose of sponsoring such funds is not to control the fund or its underlying investments, but rather to sponsor, organize, and offer a pooled investment vehicle to meet customer demand.

ii. The FRB also should permit increased ownership of other investment funds.

With respect to the presumption of control regarding other investment funds, the provisions similarly should be modified to permit a 24.9% threshold for voting equity following a multi-year seeding period.[30] Banking organization-affiliated investment managers are subject to market-based constraints on their actions, particularly the ability of a third party general partner or managing member to remove the investment manager.[31] Therefore, the banking organization has only an arms-length investment management relationship with the fund. That relationship does not usurp the ability of the general partner or managing member (and the investors in the fund) to control the fund by hiring a new manager (or in the case of the investors, replacing the general partner/managing member). Accordingly, increasing the post-seeding period threshold on ownership of voting securities would

carve-out so long as the banking organization's relationship with the fund complies with applicable law. This approach would be consistent with the Volcker Rule's treatment of foreign public funds. *See* Federal Reserve Board, Volcker Rule FAQ 14, https://www.federalreserve.gov/supervisionreg/faq.htm.

[29] In calculating the amount of ownership interests in a covered fund held by a banking entity and its affiliates for purposes of the Volcker Rule's "asset management" exemption, RICs and foreign public funds are not considered to be affiliates so long as the banking entity (A) does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and (B) provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority. 12 CFR 248.12(b)(1)(ii). According to the regulatory preamble to the Volcker Rule implementing regulations, "[a]s noted above … the Board's regulations and orders have long recognized that the concept of control is different for funds than for operating companies." 79 Fed. Reg. 5355, 5372 (Jan. 31, 2014). *See also* FRB Letter dated June 24, 1999 to H. Rodgin Cohen on behalf of First Union Corporation (permitting ownership of up to 24.9% of mutual funds' voting securities after their seeding periods).

[30] Although we believe the appropriate threshold is 24.9%, we recognize that the FRB may believe a lower threshold for these funds is appropriate considering that they are not subject to extensive regulation in the same way as a RIC or foreign equivalent. In this case, we would recommend a 14.9% threshold. We believe a 4.9% threshold would limit unnecessarily the ability of banking organizations to organize and offer new funds.

[31] If a banking organization served as general partner or managing member of a fund, the fund would be "controlled" on that basis and thus the investment fund presumption of control would not be relevant. *See* 84 Fed. Reg. at 21658 (to be codified at 12 CFR 225.32(b)).

not result in the banking organization having the ability to control the fund (because, again, the banking organization-affiliated manager could be removed by the third party general partner or managing member and even at a 24.9% level of voting equity ownership, the investment manager would not be able to replace the general partner or managing member).

III. Conclusion

The FRB should adjust the Proposal to facilitate investments in emerging companies and technologies so that U.S. financial markets can remain at the forefront of global innovation in financial services. The priority issues we have addressed in this respect — adding flexibility regarding business relationships, allowing typical minority protective rights, and clarifying the treatment of equity — would ensure that banking organizations are able to partner with promising fintech firms and other emerging companies and adapt to evolving market conditions. In addition, the Proposal should be adjusted to facilitate customer-driven capital markets and asset management transactions and businesses. By adding a presumption of non-control for certain VIEs, eliminating the control presumption for entities consolidated under GAAP, and revising the RIC carve-out and investment fund presumption to allow a multi-year seeding period and greater voting equity ownership thereafter, the FRB would allow banking organizations to continue to meet their customers' evolving needs in an efficient manner.

Thank you for considering these comments. Please feel free to contact the undersigned (KFromer@fsforum.com; CMcDowell@sifma.org) with any questions.

Respectfully submitted,

Kevin Fromer

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Appendix A: About the Associations

The Financial Services Forum

The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace, and a sound financial system. For more information, please visit https://www.fsforum.com/.

The Securities Industry and Financial Markets Association

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. 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 https://www.sifma.org/.