INVESTMENT COMPANY INSTITUTE

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June 1, 2015

The Honorable Janet Yellen
Chair
The Federal Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

Re: Volcker Rule – Request For Expeditious Guidance on Seeding Period Extensions for Certain Regulated Funds and Interpretation Regarding Foreign Public Funds

Dear Chair Yellen:

The Investment Company Institute ("ICI")[1] writes to request that the Federal Reserve and other agencies ("Agencies") responsible for administering section 13 of the Bank Holding Company Act ("BHC Act"), commonly referred to as the Volcker Rule, expeditiously provide guidance, through a "frequently asked question" ("FAQ") or by similar means, clarifying the final regulations ("Final Rule") implementing the Volcker Rule regarding the points described below.

With the upcoming July 21, 2015, compliance deadline now looming, we specifically urge immediate action, discussed further below, (1) to extend the seeding period for investment companies registered, or that will be registered, under the Investment Company Act of 1940 ("registered investment companies" or "RICs") and for foreign public funds, and (2) to clarify that foreign public funds are not intended to be treated as "banking entities" under the Final Rule.[2] The clarification we request has a special urgency for existing funds, as we explain below.

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[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's US fund members manage total assets of US$18.1 trillion and serve more than 90 million US shareholders. Members of ICI Global, the international arm of ICI, manage total assets of US$1.5 trillion.

[2] We and other interested parties previously have presented these issues to the Agencies. *See, e.g.*, ICI Letter to the Agencies (Feb. 13, 2012); ICI Global Letter to the Agencies (Feb. 13, 2012); Letter of the European Fund and Asset Management Association to the Agencies (Oct. 16, 2014); Letter of Institute of International Bankers to Mr. Scott Alvarez, General Counsel, Federal Reserve (Sept. 12,

I. The Agencies Should Provide Extensions of the Seeding Period for Registered Investment Companies and Foreign Public Funds

Under the Final Rule, the Agencies indicated that banking entities may hold 25 percent or more of a RIC's voting securities without treating the RIC as a banking entity during a specified seeding period.[3] In an FAQ, the staff of the Agencies confirmed that foreign public funds would be afforded a similar treatment during their seeding period. Under the Final Rule and FAQ, banking entities are afforded a one-year seeding period with respect to RICs and foreign public funds, and they may apply to the Federal Reserve for an extension of "up to 2 additional years."[4]

ICI appreciates the Agencies' recognition of the importance of seeding arrangements for RICs and foreign public funds. Banking entities need to hold more than 25 percent positions in RICs and foreign public funds during seeding periods so that funds can execute their contemplated investment strategy and amass performance track records that are credible to investors and meet their expectations or requirements. The seeding period also allows time for successful public marketing and distribution of fund shares.

As the Agencies have recognized, the Volcker Rule was not intended to target RICs and foreign public funds, which are subject to extensive substantive regulation and oversight. We respectfully request that the Agencies clarify that the Final Rule was not intended to affect publicly offered funds' well-established seeding practices, which to our knowledge have posed no regulatory or risk issues in the past.

The significant issue for our regulated fund members is that multi-year seeding periods are quite common for (and necessary to) the successful launch of RICs and foreign public funds. To launch new RICs and foreign public funds, banking entities require certainty that they will be able to avail these funds of a sufficient seeding period. In the absence of such clarity and certainty, some banking entities simply will refrain from launching new RICs and foreign public funds, the consequence of which will be to lessen investor options with respect to investment products that the Volcker Rule was never designed to affect. The end result could be to diminish innovation and

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2014); Letter of SIFMA to Mr. Scott Alvarez, General Counsel, Federal Reserve (Oct. 20, 2014). In light of these prior submissions, and the staff's familiarity with the issues, we provide a relatively brief background in this letter. We are happy to provide additional information if the staff would find it useful.

3 79 Fed Reg. 5535, 5676-5677 (Jan. 31, 2014).

4 Final Rule __.12(a)(2)(i)(B). The one-year limit and the process for requesting extensions is borrowed from the framework that the Agencies apply to the seeding period permitted for "covered funds" sponsored under the so-called "asset management" exemption.

development of new regulated fund products that are important to investors to meet their retirement, education and other needs.

This issue has become particularly acute with respect to existing funds – those that have been formed and currently are in their seeding period, many of which currently have investors who are unaffiliated with the banking entity. These RICs and foreign public funds will require additional time beyond the upcoming July 2015 compliance deadline to avoid being deemed to be "banking entities" under the Final Rule. Unless the guidance we request is issued, or these funds are given an immediate and clear extension of the compliance deadline as it relates to seeding (preferably an extension until such time as the guidance is issued), banking entities likely will be forced to restructure the funds by selling off their stakes or by liquidating the funds. Either course will have adverse consequences for the third-party investors in the funds, which, again, was never intended by the Volcker Rule or the Final Rule.

We believe regulatory guidance is urgently needed. Liquidation and restructuring take time and, in the absence of regulatory clarification, banking entities may be compelled to initiate the necessary steps now or risk failing to come into compliance with the Final Rule by the time of the compliance deadline (a risk that these entities naturally are not willing to assume). In the case of a liquidation, there is an established and orderly process by which a fund liquidates its assets, distributes the proceeds pro rata to investors and winds up its affairs. For RICs, this process and that of other restructurings must comply with the Investment Company Act of 1940 and state or other relevant laws based on the domicile of the RIC, including consideration and approval by the RIC's board of directors.[5] All actions by the RIC's manager and directors also are undertaken in accordance with their fiduciary obligations to the RIC. Likewise, regulated funds in other parts of the world have processes that they too must follow. In the European Union, UCITS follow specified liquidation procedures as prescribed in their fund rules and the laws of the UCITS home Member State. The liquidations are subject to the fiduciary responsibilities of the UCITS' management company and/or directors, requiring the liquidation to be conducted in an orderly manner and in the best interest of investors.

This liquidation or restructuring process will, as noted above, affect third parties, including investors in the United States and abroad. Liquidation or restructuring, for example, can be expected to have tax or other consequences for the third-party investors in these funds.

Consequently, to address the immediate issue, we respectfully request that the Federal Reserve, in conjunction with the other Agencies, promptly issue guidance that provides two-year extensions, or a longer period as appropriate, to the seeding periods of these existing funds. To address fund seeding going forward, we urge the Federal

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[5] *See* Attachment "Process for Liquidating and Dissolving a US Mutual Fund."

Reserve, working with the other Agencies as needed, to make clear that a three-year seeding period, or longer as appropriate, will be readily available to RICs and foreign public funds. We also request that any required written submissions to support any extension after the first year of the seeding period be a simple and straightforward notice. We ask the Federal Reserve to issue guidance to clarify this process; it is imperative that banking entities have clear and timely guidance regarding their ability to seed RICs and foreign public funds.

II. The Agencies Should Provide Guidance that Foreign Public Funds Will Not Be Treated as Banking Entities

An additional concern regarding foreign public funds stems from the interaction of the terms "covered fund" and "banking entity" in the Final Rule. As you know, the Volcker Rule applies to "banking entities," defined under the Final Rule to include full-service insured depository institutions and foreign banking organizations ("FBOs") that are treated as bank holding companies under the International Banking Act of 1978, as well as affiliates of such entities.[6] In the Final Rule, "affiliate" is defined by cross-reference to the BHC Act.[7] Under the BHC Act, a company is an affiliate of another if the first company controls, is controlled by, or is under common control with the second. Control, in turn, is defined under the BHC Act and the Federal Reserve's regulations as one company having the power (1) to vote 25 percent or more of any class of voting securities of another company, (2) to control the election of a majority of the directors or trustees of another company or (3) to exercise a controlling influence over the management or policies of another company.[8]

The banking entity definition excludes, however, certain entities otherwise within the definition's scope, including, relevant to this letter, covered funds. Thus, a covered fund, even if it is controlled by a banking entity investor or sponsor, is not subject to the Final Rule's prohibitions on proprietary trading and investing in, and sponsorship of, other covered funds. This exclusion means that a covered fund that a banking entity advises or manages, or in which a banking entity invests, is able to engage in trading and investing on behalf of the funds' beneficial owners, subject to certain conditions.

As originally proposed, the covered fund definition was exceedingly broad and included investment vehicles that were not the intended subject of the Volcker Rule's

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6 Final Rule § _.2(c).

7 Final Rule § _.2(a) (referencing the BHC Act definition of affiliate, 12 U.S.C. § 1841(k)).

8 12 U.S.C. § 1841(a)(2); 12 C.F.R. 225.2(e).

restrictions and prohibitions.[9] The Agencies recognized this potential over-reach and appropriately and correctly tailored the covered fund definition by excluding, among other vehicles, RICs and foreign public funds.

RICs and foreign public funds, however, were not excluded from the definition of banking entity and cannot rely on the covered fund carve-out. The preamble discussion to the Final Rule indicates that the Agencies considered this issue with respect to RICs. There, the Agencies explained that (1) a RIC would be a banking entity under the Final Rule only if it were an affiliate of an insured depository institution covered by the Final Rule, and (2) pursuant to a long line of Federal Reserve precedent, a RIC ordinarily would not be considered an affiliate of such an insured depository institution (even if that institution or its affiliates provided investment advisory, administrative or other services to the RIC).

Unfortunately, the Agencies did not address the fact that many foreign public funds do not and, in many cases, cannot operate in the same manner as RICs and, therefore, cannot rely on prior Federal Reserve precedents that allow banking entities to avoid "controlling" a RIC. For example, UCITS that are organized as trusts or contractual funds do not have a board of directors and, therefore, cannot rely on the Federal Reserve's precedents. Regulated funds in other countries also may rely on an affiliate of the sponsoring bank to have oversight duties akin to the role of a board. In particular, for many foreign public funds, the depositary has responsibility for many oversight responsibilities and is required by local law to carry out those responsibilities. As a result of these circumstances, the Agencies have left open the question of how foreign public funds are treated under the Final Rule and its definition of "banking entity" and have left unresolved whether foreign public funds could be captured by this definition where such funds – as is often the case – could be deemed controlled by a banking entity.

Consequently, a significant portion of foreign public funds could be deemed "banking entities" and, thus, subject to the Volcker Rule's prohibitions. It is not clear what policy objective this result serves, and we suspect that it was unintended – but the consequence is highly adverse in that it renders the Final Rule's attempt to accommodate foreign public funds meaningless. Under this interpretation of the Final Rule, banking entity-controlled foreign public funds and their managers would not be able to engage in quite normal investment activities (which are likely to fall within the Volcker Rule's

[9] 79 Fed Reg. at 5671 (adopting "a tailored definition of covered fund in the final rule ... with exclusions for certain specific types of issuers in order to focus the covered fund definition on vehicles used for the investment purposes that were the target of section 13").

prohibitions on proprietary trading) consistent with their fiduciary duties and the investment mandates of their funds.[10]

Clearly, treating a foreign public fund as a banking entity would defeat the Agencies' goal of using the foreign public funds exclusion to "limit the extraterritorial application of section 13 of the BHC Act" and reduce "the potential economic burdens" associated with applying the Final Rule.[11] Foreign public funds in effect would receive worse treatment under the Final Rule than covered funds (the very vehicles with which Congress was concerned in enacting the Volcker Rule) and quite different treatment than RICs (the treatment of which the Agencies attempted to mirror for foreign public funds). We respectfully submit that this outcome makes no sense, and we request that the Agencies promptly issue public guidance to clarify that foreign public funds will not be treated as banking entities.

Prompt action on this issue is important. Foreign public funds are retail investment products that banking entities need to form on a regular basis to meet the evolving investment needs of individual investors in many international markets. The lack of certainty as to whether such funds could fall within the definition of "banking entity" under the Final Rule – and, thus, face restrictions from ordinary course trading and investing activities – will necessarily chill normal foreign business activities. In particular, banking entities cannot confidently form new funds if there is a significant regulatory cloud over the fund structure that they are marketing, as the fund potentially may need to be wound up or restructured in a way that leads to significant confusion and costs for investors. We do not believe this substantial extraterritorial impact and disruption was intended under the Volcker Rule or by the Agencies.

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In emphasizing this need for prompt action, we recognize and appreciate that, in December 2014, the Federal Reserve helpfully extended the Volcker Rule conformance period until July 21, 2016 (and indicated that it will further extend the conformance period until July 21, 2017). But, as the Agencies well know, this extension is limited to "investments in and relationships with covered and foreign funds" that were in place prior to December 31, 2013. Thus, the plain language of the extension does not clearly alleviate the seeding issue for RICs. It also does not address the "banking entity" or

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[10] It is conceivable that some (but not all) foreign public funds may be able to avoid this result by being restructured. Doing so, however, would be expensive and time-consuming. The restructuring also could result in fund structures that are off-market and possibly confusing to retail investors in local jurisdictions. It is difficult to understand what policy goal is achieved by forcing such restructurings, which, as noted, may not be possible in all cases due to home country legal requirements and market practices.

[11] 79 Fed. Reg. at 5679.

seeding issue for RICs or foreign public funds sponsored by banking entities in 2014 and beyond and, given that such vehicles are regularly offered and seeded to meet investor demands, the extension does not lessen the urgency of the situation.

In summary, for the reasons described above, we respectfully request (1) the Federal Reserve promptly provide a sufficient (multi-year) seeding period for existing funds and make clear that, going forward, a multi-year seeding period will be equally available for newly-formed RICs and foreign public funds, and (2) the Agencies issue public guidance to clarify that foreign public funds will not be treated as banking entities.

Thank you for your attention to our letter and consideration of our request. Your staff should not hesitate to contact me, ICI's General Counsel, David Blass, at (202) 326-5815 or david.blass@ici.org, or ICI Global's Chief Counsel, Susan Olson, at (202) 326-5813 or solson@ici.org, if we can be of assistance as you consider these issues.

Sincerely,

Paul Schott Stevens
President & CEO
Investment Company Institute

Attachment – Process for Liquidating and Dissolving a US Mutual Fund

cc: Thomas J. Curry, Comptroller
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Federal Deposit Insurance Corporation
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Process for Liquidating and Dissolving a Mutual Fund*

1. Consideration of whether to liquidate the fund, by fund manager and fund board
2. Determine whether approval by fund investors is needed, based upon state law and the fund's charter documents
3. Prepare a plan of liquidation and dissolution
4. Fund board to consider and approve the plan of liquidation and dissolution
    a. Fund directors to consider the details of the proposed plan and the rationale for liquidating the fund
        i. Is liquidation and dissolution in the best interests of the fund?
        ii. Are there other viable options?
    b. Directors will make a determination based on their duties to the fund
5. Announce the plan of liquidation and related details
    a. Date on which fund will be closed to new investors
    b. Date on which liquidation proceeds will be paid to investors ("Closing Date")
        i. The Closing Date will depend upon factors such as portfolio liquidity, the degree of ease in converting portfolio securities to cash or cash equivalents, recommendations of the fund's portfolio manager, and the fund's investment strategy and objectives
    c. Description of how purchases, redemptions and exchanges will be conducted during the period prior to the Closing Date
6. Fund to begin the liquidation process
    a. Set aside reserves for liquidation-related expenses (typically limited)
    b. Pay any debts or other obligations (often limited to previously accrued fees to service providers)
    c. Begin to convert portfolio securities to cash or cash equivalents
7. Pay liquidation proceeds to investors on the Closing Date
8. File last financial reports with the SEC
9. File an application with the SEC for deregistration of the fund (on Form N-8F)
10. File with the state to dissolve the fund (typically a perfunctory filing)

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* For further detail, *see* Jack Murphy, Julien Bourgeois and Lisa Price, *How a Fund Dies*, Review of Securities & Commodities Regulation, Vol. 43 No. 21 (Dec. 1, 2010).