

## Foreign Public Funds Sponsored by Banking Entities

### 14. How does the final rule apply to a foreign public fund sponsored by a banking entity?

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The final rule excludes foreign public funds from the definition of covered fund.<sup>1</sup> To qualify for this exclusion, these funds must, among other conditions, be authorized to offer and sell ownership interests to retail investors in the foreign public fund's home jurisdiction and must sell ownership interests predominantly in public offerings outside of the United States.<sup>2</sup> The Agencies stated that this exclusion was "designed to prevent . . . the definition of covered fund from including foreign funds that are similar to U.S. registered investment companies, which are by statute not covered by section 13."<sup>3</sup> The Agencies also stated that the "foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States."<sup>4</sup>

Staffs of the Agencies understand that, unlike in the case of U.S. registered investment companies,<sup>5</sup> sponsors of foreign public funds in some foreign jurisdictions select the majority of the fund's directors or trustees, or otherwise control the fund for purposes of the BHC Act by contract or through a controlled corporate director. These and other corporate governance structures abroad therefore have raised questions regarding whether foreign public funds that are sponsored and distributed outside the U.S. and in accordance with foreign laws are banking entities by virtue of their relationships with a banking entity.

As noted by the Agencies in the preamble to the final rule, the definition of private equity fund and hedge fund in section 619 of the Dodd-Frank Act appears to reflect Congressional concerns regarding less regulated private funds as well as an intention not to disrupt registered investment companies, such as U.S. mutual funds.<sup>6</sup> The final implementing regulations issued by the Agencies adopted the same approach toward foreign public funds in order to make clear that U.S. banking entities and their foreign affiliates, as well as foreign banking organizations, could continue to carry on their traditional asset management businesses involving foreign public funds outside of the United States.<sup>7</sup> The final rule imposes conditions to ensure that the foreign public fund is distributed predominantly through public offerings outside the United States, is offered to retail investors in the issuer's home jurisdiction, is distributed in accordance with all applicable requirements for distributing public funds in the jurisdiction in which the distribution is being made, and includes publicly available offering disclosure documents. These requirements were designed to mirror the characteristics of U.S. mutual funds that are outside the applicability of section 619 of the Dodd-Frank Act.<sup>8</sup>

By referring to characteristics common to publicly distributed foreign funds rather than requiring that foreign public funds organize themselves identically to U.S. mutual funds or other types of U.S. regulated investment companies, the final rule recognized that foreign jurisdictions have established their own frameworks governing the details for the operation and distribution of foreign public funds.

Section 351.12 of the final rule further provides that, for purposes of complying with the covered fund investment limits, a U.S. registered investment company, SEC-regulated business development company, or foreign public fund will not be considered to be an affiliate of the banking entity so long as the banking entity: (i) does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the fund; and (ii) provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with the limitations under applicable regulation, order, or other authority. The staffs of the Agencies note that these limitations would include those imposed by an authority in the relevant foreign jurisdiction.<sup>9</sup>

Staffs of the Agencies would not advise that the activities and investments of a foreign public fund that meets the requirements in section 351.10(c)(1) and section 351.12(b)(1) of the final rule be attributed to the banking entity for purposes of section 619 of the Dodd-Frank Act or the final rule where, consistent with section 351.12(b)(1) of the final rule, the banking entity does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the foreign public fund (after the seeding period)<sup>10</sup>, and provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with applicable limitations in the relevant foreign jurisdiction. Nor would the staffs advise that a foreign public fund be deemed a banking entity under the final rule solely by virtue of its relationship with the sponsoring banking

entity where the foreign public fund meets the requirements of section 351.10(c)(1) of the final rule and the sponsoring banking entity's relationship with the foreign public fund meets the requirements of section 351.12(b)(1) of the final rule, including the requirement that the sponsoring banking entity's relationship with the fund is in compliance with applicable limitations in the foreign jurisdiction in which the foreign public fund operates.

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<sup>1</sup> See § 351.10(c)(1). The final rule defines the term "covered fund" to include certain funds that rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act; certain commodity pools as defined in section 1a(10) of the Commodity Exchange Act; and certain foreign funds. See § 351.10(b)(1).

<sup>2</sup> See § 351.10(c)(1).

<sup>3</sup> 79 FR at 5673. The Agencies also noted more generally that the exclusions from the covered fund definition were designed, among other purposes, "to address the potential over-breadth of the covered fund definition and related requirements without such exclusions by permitting banking entities to invest in and have other relationships with entities that do not relate to the statutory purpose of section 13." 79 FR at 5677.

<sup>4</sup> 79 FR at 5678. The Agencies explained in the preamble that they "tailored the final definition [of covered fund] to include entities of the type that the Agencies believe Congress intended to capture in its definition of private equity fund and hedge fund in section 13(h)(2) of the BHC Act by reference to section 3(c)(1) and 3(c)(7) of the Investment Company Act. Thus, the final definition focuses on the types of entities formed for the purpose of investing in securities or derivatives for resale or otherwise trading in securities or derivatives, and that are offered and sold in offerings that do not involve a public offering, but typically involve offerings to institutional investors and high-net worth individuals (rather than to retail investors)." 79 FR at 5666.

<sup>5</sup> See 79 FR at 5676 (recognizing that the Federal Reserve Board's regulations and orders have long recognized that a bank holding company may organize, sponsor, and manage a registered investment company, including by serving as investment adviser to the registered investment company, without controlling the registered investment company for purposes of the BHC Act).

<sup>6</sup> See, e.g., 79 FR at 5675 ("Section 13's definition of private equity fund and hedge fund by reference to section 3(c)(1) and 3(c)(7) of the Investment Company Act appears to reflect Congress' concerns about banking entities' exposure to and relationships with investment funds that explicitly are *excluded* from SEC regulation as investment companies."). (emphasis in original) See also e.g., 79 FR at 5666.

<sup>7</sup> 79 FR at 5678 (stating "the Agencies' view that the foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States").

<sup>8</sup> 79 FR at 5678.

<sup>9</sup> See § 351.12(b)(1)(ii). See also 79 FR at 5732 ("[F]or purposes of section 13 of the BHC Act and the final rule, a registered investment company, SEC-regulated business development company, and a foreign public fund as described in § 351.10(c)(1) of the final rule will not be considered to be an affiliate of the banking entity if the banking entity owns, controls, or holds with the power to vote less than 25 percent of the voting shares of the company or fund, and provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund only in a manner that complies with other limitations under applicable regulation, order, or other authority.")

<sup>10</sup> See §§ 351.10(c)(12) and 351.20(e). The preamble to the final rule makes clear that, consistent with the Board's precedent regarding bank holding company control of and relationships with funds, a seeding vehicle that will become a registered investment company would not itself be viewed as violating the requirements of section 13 during the seeding period so long as the banking entity that establishes the seeding vehicle operates the vehicle pursuant to a written plan, developed in accordance with the banking entity's compliance program, that reflects the banking entity's determination that the vehicle will become a registered investment company within the time period provided for seeding a covered fund. See 79 FR at 5676-77. The staffs of the Agencies have explained that an issuer that will become a foreign public fund would be treated during its seeding period in the same manner as an issuer that will become an excluded registered investment company. <https://fdic.gov/regulations/reform/volcker/faq/foreign.html>.