July 10, 2019

Volcker Rule

Federal Banking Agencies, SEC and CFTC Approve Final Rule to Exclude Certain Smaller Institutions from Banking Entity Status and Modify Fund Name-Sharing Restrictions, Conforming to the Economic Growth, Regulatory Relief, and Consumer Protection Act

On July 9, 2019, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Office of the Comptroller of the Currency (the "OCC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC" and collectively, the "Agencies") released final rules adopting their previously proposed amendments to the regulations implementing Section 13 of the Bank Holding Company Act of 1956 (the "BHC Act"),[1] known as the "Volcker Rule."

The amendments modify the Volcker Rule implementing regulations in a manner consistent with Sections 203 and 204 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "EGRRCPA").[2] Under Section 203 of the EGRRCPA, institutions that have total consolidated assets equal to $10 billion or less and total trading assets and liabilities equal to five percent or less of total consolidated assets are excluded from the definition of "insured depository institution," and therefore generally are excluded from the scope of "banking entities" that are subject to the Volcker Rule's restrictions and compliance program requirements. Section 204 of the EGRRCPA modified the restrictions on the sharing of a name (or variation of the same name) between a banking entity and a hedge fund or private equity fund so as to permit a banking entity that serves as an investment adviser for a fund to share a name with that fund, subject to certain conditions. The Agencies' release accompanying the amendments (the "Adopting Release") confirmed that Sections 203 and 204 of the EGRRCPA became effective upon enactment of the statute on May 24, 2018.[3]

DISCUSSION

The amendments adopted by the Agencies are unchanged from those that the Agencies proposed in their notice of proposed rulemaking in February 2019.[4] Appendix A to this Memorandum provides a comparison of the text of selected provisions of the 2013 Rule (as defined below) against the text of such provisions that will become effective on the first day following publication of the amendments in the Federal Register.

The Volcker Rule, as implemented by the regulations adopted by the Agencies in December 2013 (the "2013 Rule"), imposes broad prohibitions on banking entities from engaging in proprietary trading and investing in and sponsoring private equity funds, hedge funds and certain other investment vehicles—referred to as "covered funds" in the 2013 Rule—and requires banking entities to establish an internal compliance program that is reasonably designed to ensure and monitor compliance with the Volcker Rule.[5] The 2013 Rule is the subject of an ongoing rulemaking process, separate from the rulemaking that concluded with the adoption of the amendments described here, that commenced with a proposal issued by the Agencies during the summer of 2018.[6]

A. EXCLUSION FROM DEFINITION OF "INSURED DEPOSITORY INSTITUTION"

The amendments modify the definition of "insured depository institution" in the 2013 Rule by excluding an institution that satisfies two conditions, consistent with Section 203 of the EGRRCPA. First, the institution, and every entity that controls it, must have total consolidated assets equal to or less than $10 billion. Second, total consolidated trading assets and liabilities of the institution, and every entity that controls it, must be equal to or less than five percent of total consolidated assets. Any insured depository institution that meets both of these conditions (as well as any subsidiary or affiliate of such an institution) generally would not be a "banking entity" and therefore would not be subject to the Volcker Rule or the 2013 Rule, unless it is a banking entity by virtue of being affiliated with another insured depository institution that does not qualify for the exclusion, or with a company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978 (the "IBA").[7]

In the Adopting Release, the Agencies confirmed that a bank or savings association seeking to determine its eligibility for the exclusion may use its most recent quarterly Consolidated Report of Condition and Income (commonly referred to as a "call report") as the source of data for its consolidated assets and its total trading assets and liabilities at the bank or savings association level.[8] Similarly, a banking organization may use the most recent filing of Form FR Y-9C by its holding company as the source of data about the consolidated assets and total trading assets and liabilities of the companies controlling the bank or savings association. The Agencies instructed that institutions should classify assets and liabilities consistent with the instructions to the relevant report in consultation with appropriate supervisors, as necessary.[9]

In the Adopting Release, the Agencies rejected the suggestion made by certain commenters that the exclusion provided by Section 203 of the EGRRCPA extended to firms with *either* $10 billion or less in total consolidated assets *or* trading assets and liabilities equal to five percent or less of total consolidated assets.[10] The Agencies called these arguments unpersuasive, stating that the requirement that *both* criteria be satisfied in order to qualify for the exclusion "is most consistent with the statutory language of EGRRCPA, the congressional intent behind the statute, and the structure of the statute as a whole."[11]

B. EXEMPTION FROM RESTRICTION ON NAME-SHARING BETWEEN BANKING ENTITY AND COVERED FUNDS

The amendments also provide an exemption from the restriction on a banking entity (or an affiliate of the banking entity) sharing the same name or a variation of the same name with a covered fund.[12] Under the Volcker Rule and the 2013 Rule, banking entities are generally prohibited from serving as the "sponsor" to a covered fund, absent an exemption or exclusion.[13] The definition of "sponsor" for this purpose includes a banking entity that shares the same name or a variation of the same name with a fund for corporate, marketing, promotional, or other purposes.[14] Name-sharing is also prohibited with respect to a covered fund that a banking entity permissibly sponsors under the so-called "organizing and offering exemption."[15]

As amended, the regulations will permit a covered fund to share the same name or a variation of the same name with a banking entity (or an affiliate of the banking entity) that is an investment adviser to the fund, subject to two conditions. First, the investment adviser is not, and does not share the same name (or a variation of the same name) as, an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of Section 8 of the IBA.[16] Second, the investment adviser's name does not contain the word "bank."[17]

The amendments also modify the definition of "sponsor" in the 2013 Rule to conform to Section 204 of the EGRRCPA.[18] As amended, the definition of "sponsor" for purposes of the 2013 Rule will not include name-sharing that is permitted in accordance with the conditions described above, but will otherwise continue to include sharing the same name or a variation of the same name with a covered fund for corporate, marketing, promotional, or other purposes.

* * *

ENDNOTES

1 12 U.S.C. § 1851.

2 EGRRCPA, Pub. L. 115-174 (May 24, 2018).

3 Adopting Release at 4 n.6.

4 *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 84 Fed. Reg. 2778 (Feb. 8, 2019).

5 For a discussion of the requirements of the 2013 Rule, please see our Client Memorandum, *Volcker Rule: U.S. Agencies Approve Final Volcker Rule, Detailing Prohibitions and Compliance Regimes Applicable to Banking Entities Worldwide*, dated January 27, 2014, *available at* https://www.sullcrom.com/Volcker-Rule-01-27-2014.

6 For a discussion of this notice of proposed rulemaking, please see our Client Memorandum, *Federal Banking Agencies and CFTC Approve Notice of Proposed Rulemaking to Amend Volcker Rule Regulations; SEC Expected to Follow*, dated June 5, 2018, available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Volcker_Rule_06_05_18.pdf.

7 Adopting Release at 5 n.9. *See also* 12 U.S.C. § 1851(h)(1); 2013 Rule § _.2(c)(1).

8 Adopting Release at 9.

9 Id. at 10.

10 Id. at 7.

11 Id. at 8.

12 2013 Rule § _.11(a)(6).

13 12 U.S.C. § 1851(a)(1)(B); 2013 Rule § _.10(a)(1).

14 12 U.S.C. § 1851(h)(5); 2013 Rule § _.10(d)(9).

15 2013 Rule § _.11(a)(6).

16 12 U.S.C. §§ 1851(d)(1)(G)(vi)(I); 12 U.S.C. 1851(d)(1)(G)(vi)(II).

17 12 U.S.C. § 1851(d)(1)(G)(vi)(III); 2013 Rule § _.10(d)(9). Section 204 of the EGRRCPA included the additional condition that the name of the fund may not contain the word “bank” in order to qualify for the exemption, but because this condition is already included in the 2013 Rule’s organizing and offering exemption (2013 Rule § _.11(a)(6)(ii)), the Agencies did not make any additional modifications to the rule to reflect this condition.

18 12 U.S.C. § 1851(h)(5); 2013 Rule § _.10(d)(9).

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APPENDIX A[1]

Subpart A — Authority and Definitions

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§ __.1 Authority, purpose, scope, and relationship to other authorities

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(c) *Scope*. This part implements section 13 of the Bank Holding Company Act with respect to banking entities for which the Board is authorized to issue regulations under section 13(b)(2) of the Bank Holding Company Act (12 U.S.C. 1851(b)(2)) and take actions under section 13(e) of that Act (12 U.S.C. 1851(e)). These include any state bank that is a member of the Federal Reserve System, any company that controls an insured depository institution (including a bank holding company and savings and loan holding company), any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act (12 U.S.C. 3106), and any subsidiary of the foregoing other than a subsidiary for which the OCC, FDIC, CFTC, or SEC is the primary financial regulatory agency (as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5301(12~~))~~.)), but do not include such entities to the extent they are not within the definition of banking entity in § 248.2(c) of this subpart.

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§__.2 Definitions

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(r) *Insured depository institution* unless otherwise indicated, has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) an insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D~~))~~.)); or

(2) an insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

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Subpart C — Covered Funds Activities and Investments

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§ __.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund

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(d)

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(9) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

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[1] The language of the regulations have minor technical differences among Agencies due to cross references. The language shown in this Appendix A is from the Federal Reserve regulations. The substantive amendments are the same for each Agency.

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name~~.~~, except as permitted under § 248.11(a)(6).

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§ __.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund

(a)

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(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof~~); and~~) except that a covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

(A) The investment adviser is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(B) The investment adviser does not share the same name or a variation of the same name as an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(ii) Does not use the word “bank” in its name.