The Debrief

Volcker Rule: Regulatory Relief Act Changes and Two-Year Extension of SOTUS Opt-in Relief

July 29, 2019

On July 9, 2019, the Federal Reserve Board and other agencies charged with implementing the Volcker Rule adopted a final rule that would modify the definition of "banking entity" and alter the covered fund name-sharing restriction.[1] The revisions bring the existing implementing regulations in line with statutory changes made by the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Regulatory Relief Act").[2] The final rule is unchanged from the proposed rule published on February 8, 2019.[3] In addition, on July 17, 2019, the federal banking agencies announced[4] that they would extend "no-action" relief with respect to certain "foreign excluded funds" for an additional two-year period, until July 21, 2021.[5]

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"BANKING ENTITY" DEFINITION

Prior to enactment of the Regulatory Relief Act, the statutory definition of "banking entity," which defines the scope of firms subject to the Volcker Rule, included any insured depository institution, any company that controls an insured depository institution, or that is treated as a bank holding company under section 8 of the International Banking Act ("IBA"), and any affiliate or subsidiary of such entity. The definition for "insured depository institution" included a carve-out for certain firms that function solely in a trust or fiduciary capacity.

The final rule adds an additional carve-out for an insured depository institution that satisfies two conditions. *First*, the insured depository institution, and every company that controls it, must have total consolidated assets equal to or less than $10 billion.

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1 Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 35008 (July 22, 2019).

2 See our prior analysis regarding the Regulatory Relief Act.

3 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). See our prior analysis of the proposal.

4 Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 17, 2019) (link here).

5 See our prior analysis regarding the original "no-action" relief.

Second, the total trading assets and liabilities of the insured depository institution, and every company that controls it, must be equal to or less than 5% of its total consolidated assets.[6] The final rule does not change the application of the banking entity definition with respect to foreign banking organizations.

Some commenters had suggested that the Regulatory Relief Act's revisions to the banking entity definition be interpreted as extending relief to firms with *either* $10 billion or less in total consolidated assets *or* trading assets and liabilities equal to or less than 5% of total consolidated assets.[7] The agencies explicitly declined to adopt this interpretation, reasoning that the approach of requiring both conditions to be satisfied "is most consistent with the statutory language of [the Regulatory Relief Act], the congressional intent behind the statute, and the structure of the statute as a whole."[8]

The agencies also declined to adopt a request from commenters to provide relief from the control definition for investors in industrial loan companies ("ILCs") or an exclusion from the Volcker Rule for such investors. The agencies said that they did not find support for such relief or exclusion in the Volcker Rule statute or the Regulatory Relief Act and, accordingly, said that they would not adopt an exemption from the Volcker Rule for parent ILCs or investors in parent ILCs. To our knowledge, this is the first time the agencies have officially and jointly spoken to the status of ILC parents since the original implementing regulations were finalized.

COVERED FUND NAME-SHARING RESTRICTION

Prior to the Regulatory Relief Act's enactment, a covered fund that was sponsored or organized and offered by a banking entity under the so-called asset management exemption was prohibited from sharing "the same name or a variation of the same name with the banking entity (or an affiliate thereof)." The final rule modifies the name-sharing restriction so that, under the asset management exemption, a banking entity may sponsor or organize and offer a covered fund with the same name or a variation of the same name as a banking entity that is an investment adviser to the fund, so long as: (1) 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

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6 The final rule clarifies that a banking organization seeking to determine its eligibility for the exclusion may use its most recent quarterly regulatory report (*e.g.*, a Call Report for a bank or savings association or the FR Y-9C for a bank holding company) to measure its consolidated assets and total trading assets and liabilities. 84 Fed. Reg. at 35010.

7 *See, e.g.*, Letter from Rep. Blaine Luetkemeyer to the heads of the Volcker Rule implementing agencies and Treasury Secretary Steven Mnuchin (Dec. 21, 2018); *see also* 84 Fed. Reg. at 35009 & n.16.

8 84 Fed. Reg. at 35010.

holding company under section 8 of the IBA; and (2) the fund name does not use the word "bank" (continuing a requirement in the existing implementing regulations).[9] The final rule would make conforming changes to the definition of the term "sponsor" as well.

SOTUS OPT-IN RELIEF EXTENDED

As noted in our prior analysis, the federal banking agencies in July 2017 previously took action to grant so-called SOTUS opt-in relief for "qualifying foreign excluded funds." Under the SOTUS opt-in relief, the agencies stated that they would not propose to take action against either a non-U.S. banking entity or a foreign excluded fund that is an affiliate of the non-U.S. banking entity based on the activities of that foreign fund. That is, the fund — despite being an affiliate of a non-U.S. bank with a U.S. banking presence — may engage in trading and other activities that do not comply with the Volcker Rule's prohibitions. To qualify for this relief, the fund must meet enumerated requirements to be a "qualifying foreign excluded fund," and the non-U.S. banking entity's investment in or sponsorship of the foreign excluded fund must meet the requirements of the "solely outside the United States" exemption (the "SOTUS opt-in" aspect of the relief).

This relief was time limited, lasting until July 21, 2018. When the implementing agencies proposed revisions to the Volcker Rule implementing regulations in the summer of 2018 (see our prior analysis of the proposal), this relief was further extended to July 21, 2019. Thus, without further action, the relief would have expired this month. In extending the relief for two years, until July 21, 2021, the agencies maintained the criteria from the original relief for a "qualifying foreign excluded fund" and, in so doing, have provided certainty for foreign banking entities that they can continue to rely on this relief without changing practices or procedures. We also expect the agencies will seek to find a permanent solution through revisions to the existing implementing regulations before the two-year period expires.

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[9] The preamble is not clear as to whether the agencies believe the Regulatory Relief Act's condition regarding the use of the word "bank" in the name applies only to the fund or also to the investment adviser. In one instance, the preamble states that a condition is that "the investment adviser's name does not contain the word 'bank.'" *See* 84 Fed. Reg. at 35011. The preamble to the proposal, on the other hand, does not clearly state this as a condition, *see* 84 Fed. Reg. at 2781, and the final regulatory text only refers to the name of the fund.

Please do not hesitate to contact us with any questions.

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