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Alert

Volcker Rule Update: Agencies Adopt Final Rule to Exclude Community Banks and Modify the Name-Sharing Restriction

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On July 9, 2019, the five federal financial regulatory agencies jointly responsible for implementing the Volcker Rule[1] (collectively, "Agencies" [2]) adopted a new final rule which makes certain amendments to their Volcker Rule regulations, consistent with the statutory amendments made to the Volcker Rule by the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"). A copy of the joint press release (and a link to the full text of the final rule) is available here.

Enacted on May 24, 2018, the EGRRCPA amended the Volker Rule by:

- Modifying the definition of "insured depository institution" to exclude certain community banks and, therefore, exclude them from the category of "banking entities" to which the Volcker Rule applies; and
- Permitting a banking entity that acts as an investment adviser to share, under certain circumstances, its name or a variation thereof with the hedge funds or private equity funds it sponsors.

Exclusion of Community Banks

The Agencies amended their regulations to conform with the EGRRCPA's modifications to the definition of "insured depository institution" so as to exclude certain community banks and their affiliates from the requirements of the Volcker Rule. The amended definition of "insured depository institution" now excludes any insured depository institution if it, and every company that controls it, has:

1) Total consolidated assets of $10 billion or less; and
2) Total trading assets and trading liabilities, on a consolidated basis, that are 5% or less of total consolidated assets.

An insured depository institution must satisfy these two conditions for it and its affiliates to qualify for the exclusion. Moreover, it is important to note that the exclusion does not apply to a foreign banking organization, even if it would otherwise meet the two conditions of the exclusion. This is due to the fact that the EGRRCPA did not amend the definition for "banking entity" as it relates to foreign banking organizations.

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[1] Section 13 of the Bank Holding Company Act, 12 U.S.C. § 1851.

[2] The Board of Governors of the Federal Reserve System ("Board"), Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Commodity Futures Trading Commission.

Once the eligibility requirements are met, the institution is no longer subject to the Volcker Rule's requirements. No additional action by the Agencies is required for the exclusion to take effect.

To determine which institutions are excluded, the Agencies will only review the information in the institution's most recent applicable regulatory filing. Accordingly, a bank or savings association may use its most recent quarterly Consolidated Report of Condition and Income (commonly, "call report") to determine its consolidated assets and total trading assets and liabilities at the bank or savings association level. Similarly, a banking organization may use its most recent filing of the Board's 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 also addressed some comments asking for clarification on whether certain securities were "trading assets" for purposes of determining eligibility for the exclusion. The Agencies clarified that securities appropriately classified as available for sale are not trading assets. However, the Agencies noted that the question of how to classify specific types of assets, including assets held in connection with employee deferred compensation programs, on the regulatory filings is fact-specific and that the assets should be classified consistent with the relevant report's instructions in consultation with appropriate supervisors, as necessary.

Modification of Name-Sharing Restriction

The Agencies also amended their regulations to conform to the EGRRCPA's changes which, under certain circumstances, permit an investment adviser that is a banking entity to share its name with a hedge fund or private equity fund that it organizes and offers. Under the amended regulations, a banking entity that is an investment adviser is permitted to share the same name or a variation of the same name with a "covered fund"[3] it sponsors if:

1) 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;
2) The investment adviser does not share the same or 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; and
3) The investment adviser's name does not contain the word "bank."

Even though some commenters proposed changes to allow banking entities to share a name with a covered fund if required or expected by foreign regulators, the Agencies did not adopt the requested changes as the EGRRCPA did not provide such an exclusion.

The Agencies also made conforming changes to the definition of "sponsor" to include this name-sharing exception.

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[3] While the statute applies the restrictions and conditions to "hedge funds" and "private equity funds," the regulations apply to "covered funds" as defined in § __.10(b) of the regulations. *E.g.,* 12 C.F.R. § 248.10(b). The primary component of that definition is any issuer that would be an investment company under the Investment Company Act of 1940 but for the exemptions contained in Sections 3(c)(1) and 3(c)(7) therein.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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