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Client Alert Commentary

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Two Proposed Volcker Rule Updates: "Banking Entity" Definition and Name-Sharing Restriction

The proposed modifications, if adopted, would amend the Volcker Rule in a manner consistent with the statutory amendments under the Economic Growth, Regulatory Relief, and Consumer Protection Act.

The Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which was enacted on May 24, 2018,[1] modified certain post-financial crisis regulatory requirements, including Section 13 of the Bank Holding Company Act of 1956, as amended, and its implementing regulations (Volcker Rule). The EGRRCPA amended the Volcker Rule, in part, by narrowing the scope of the term "banking entity" and limiting, under certain circumstances, the restrictions imposed on banking entities with respect to name-sharing with certain hedge funds and private equity funds that they organize and offer. Following the adoption of the EGRRCPA, the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) jointly issued a statement indicating their intention to address the EGRRCPA's statutory amendments to the Volcker Rule through a separate rulemaking process.[2] On December 18, 2018, the Federal Reserve, the OCC, the FDIC, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively, the Agencies) released a notice of proposed rulemaking (Proposal) to amend the Volcker Rule in a manner consistent with the statutory amendments made pursuant to the EGRRCPA.[3]

Proposed Update 1: Narrowing of "Banking Entity" Definition

Prior to the statutory amendments under the EGRRCPA, the Volcker Rule's definition of "banking entity" included any:

- Insured depository institution, as defined in the Federal Deposit Insurance Act;
- Company that controls an insured depository institution;
- Company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978 (IBA); and
- Affiliate or subsidiary of the foregoing (excluding from the term "insured depository institution" certain insured depository institutions that function solely in a trust or fiduciary capacity, subject to certain conditions).

Section 203 of the EGRRCPA narrows the "banking entity" definition under the Volcker Rule by excluding from the term "insured depository institution" an institution that does not have, and is not controlled by a company that has:

- More than US$10 billion in total consolidated assets; and
- Total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5% of total consolidated assets.

The intended effect of narrowing the scope of the "banking entity" definition is to reduce the regulatory burden imposed by the Volcker Rule on community banks, which generally include banks with total consolidated assets of less than US$10 billion and limited trading activities.

Consistent with the EGRRCPA, the Agencies propose modifying the term "insured depository institution" under the Volcker Rule in order to conform such term with Section 203 of the EGRRCPA. Under the Proposal, an insured depository institution would be excluded from the Volcker Rule's "banking entity" definition if both of the following conditions are satisfied:

- The insured depository institution, and every entity that controls it, must have total consolidated assets equal to or less than US$10 billion; and
- Total consolidated trading assets and liabilities of the insured depository institution, and every entity that controls it, must be equal to or less than 5% of its total consolidated assets.

Some interpretations of Section 203 of the EGRRCPA suggested that the wording of the statutory amendment to the "banking entity" definition left ambiguous whether banks were required to meet both the threshold regarding total consolidated assets and the threshold regarding trading assets and liabilities, which would have created a potential exemption from the Volcker Rule for larger banks with total consolidated assets in excess of US$10 billion and limited trading activities. The Proposal makes clear, however, that the exemption from the Volcker Rule would only be available to those banks that do not exceed both thresholds.

Importantly, given that the EGRRCPA did not amend the definition of "banking entity" with respect to a company that is treated as a bank holding company pursuant to Section 8 of the IBA, the Proposal states that the statutory exclusion would not apply to a foreign banking organization (FBO) with a US branch or agency. Accordingly, FBOs with US branches or agencies would continue to be subject to the Volcker Rule's prohibitions regardless of whether such FBOs satisfy both thresholds. Industry participants representing these FBOs will likely address in comment letters to the Proposal the question of whether such disparate treatment between domestic banks and FBOs would result in a competitive disadvantage for such FBOs.

Proposed Update 2: Limitation of Name-Sharing Restriction

Prior to the adoption of the EGRRCPA, the Volcker Rule provided that a banking entity, or an affiliate of such banking entity (including an investment adviser), that organized or offered a hedge fund or private equity fund could not share the same name or a variation of the same name with the fund (the name-sharing restriction).

Section 204 of the EGRRCPA amends the name-sharing restriction under the Volcker Rule to permit a hedge fund or private equity fund that is organized and offered by a banking entity to share the same

name or a variation of the same name as the banking entity that is an investment adviser to the fund, provided that:

- 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 IBA;
- The investment adviser does not share the same name or a variation of the same name with any such entities; and
- The name does not contain the word "bank".

The Agencies propose modifying the Volcker Rule's name-sharing restriction to conform this restriction with the statutory amendments set forth in Section 204 of the EGRRCPA, with the exception of the condition that the name not contain the word "bank". Because the Volcker Rule's name-sharing restriction already includes the prohibition against using the term "bank", the Agencies express the view that no additional modifications to the Volcker Rule's name-sharing restriction are necessary to reflect this particular condition.

In addition, the Agencies also propose modifying the Volcker Rule's definition of "sponsor" in order to conform such term to include the EGRRCPA's statutory amendments to the name-sharing restriction described above.

Request for Comments to Proposed Updates

While the Agencies have requested written comments from members of the public regarding all aspects of the Proposal, they are particularly interested in hearing the public's views on whether the Proposal provides sufficient clarity to determine whether:

- Firms qualify for the exclusion from the "banking entity" definition; and
- A hedge fund or private equity fund sponsored by a banking entity is permitted to share the same name or a variation of the same name with an affiliated banking entity.

Comments must be submitted within 30 days following publication of the Proposal in the Federal Register.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

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Endnotes

1 Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. 115-174, §§ 203, 204 (May 24, 2018).

2 Interagency Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (July 6, 2018), *available at* https://www.occ.treas.gov/news-issuances/news-releases/2018/nr-ia-2018-69a.pdf.

3 Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (December 18, 2018), *available at* https://www.fdic.gov/news/board/2018/2018-12-18-notice-sum-b-fr.pdf.