

September 7, 2018

**TO:** The Board of Directors

**FROM:** Doreen R. Eberley  
Director, Division of Risk Management Supervision

**SUBJECT:** *Interim final rule.* Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

**Summary:** The staff of the Federal Deposit Insurance Corporation (FDIC), together with the staffs of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission and the Commodity Futures Trading Commission (the Agencies), recommends adopting an interim final rule to exclude from the Volcker Rule certain institutions that have total consolidated assets equal to \$10 billion or less and total consolidated trading assets and liabilities equal to five percent or less of total consolidated assets. The interim final rule would also amend the restrictions applicable to the naming of a hedge fund or private equity fund to permit an investment adviser that is a banking entity to share a name with the fund under certain circumstances. The interim final rule would implement sections 203 and 204 of the Economic Growth, Regulatory Relief, and Consumer Protection Act.

**Recommendation:** Staff recommends that the FDIC Board of Directors adopt and authorize the issuance of the attached interim final rule with an immediate effective date upon publication in the *Federal Register* and a 30-day public comment period.

Concur:

Charles Yi  
General Counsel

## Background

Section 13 of the Bank Holding Company Act of 1956 (BHC Act),<sup>1</sup> known as the Volcker Rule, generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund, subject to certain exemptions.<sup>2</sup>

Under the statute, authority for developing and adopting regulations to implement the prohibitions and restrictions of section 13 of the BHC Act is shared among the Agencies.<sup>3</sup> The Agencies adopted final rules implementing section 13 of the BHC Act in December 2013.<sup>4 5</sup>

The Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), enacted on May 24, 2018, amended section 13 of the BHC Act by modifying the definition of “banking entity” to exclude certain small firms and to permit a banking entity to share a name

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<sup>1</sup> 12 U.S.C. 1851. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was enacted on July 21, 2010. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). Section 619 of the Dodd-Frank Act added a new section 13 to the Bank Holding Company Act of 1956.

<sup>2</sup> *See* 12 U.S.C. 1851.

<sup>3</sup> *See* 12 U.S.C. 1851(b)(2). Under section 13(b)(2)(B) of the BHC Act, rules implementing section 13’s prohibitions and restrictions must be issued by: (i) the appropriate Federal banking agencies (i.e., the Board, the OCC, and the FDIC), jointly, with respect to insured depository institutions; (ii) the Board, with respect to any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act, any nonbank financial company supervised by the Board, and any subsidiary of any of the foregoing (other than a subsidiary for which an appropriate Federal banking agency, the SEC, or the CFTC is the primary financial regulatory agency); (iii) the CFTC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act; and (iv) the SEC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act. *See id.*

<sup>4</sup> *See* “Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule,” 79 FR 5535 (Jan. 31, 2014). The Agencies also issued an Interim Final Rule on January 31, 2014 to implement section 171 of the Dodd-Frank Act by permitting banking entities to retain certain collateralized debt obligations secured by trust preferred securities (TruPS CDOs). *See* 79 FR 5223 (Jan. 31, 2014).

<sup>5</sup> The Agencies also recently proposed amendments to these rules intended to provide additional clarity and improve supervision and implementation of the Volcker Rule. *See* “Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds,” 83 FR 33432 (July 17, 2018).

with a hedge fund or private equity fund that it organizes and offers under certain circumstances.<sup>6</sup>

The Agencies have determined to jointly adopt interim final rules to amend the regulations implementing section 13 of the BHC Act (12 CFR Part 351 for the FDIC) in a manner consistent with the statutory amendments made by EGRRCPA.

### Description of the Interim Final Rules

#### *Community Bank Exclusion under Section 203 of the EGRRCPA*

Prior to the enactment of EGRRCPA, the definition of “banking entity,” for purposes of section 13 of the BHC Act, included any insured depository institution, as defined in the Federal Deposit Insurance Act (FDI Act),<sup>7</sup> any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (IBA), and any affiliate or subsidiary of such entity (subject to certain exclusions).<sup>8</sup> EGRRCPA modifies the scope of the term “banking entity” to exclude certain community banking organizations and their affiliates.<sup>9</sup>

EGRRCPA sets forth two measurements that must both be satisfied for an institution to

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<sup>6</sup> See Economic Growth, Regulatory Relief, and Consumer Protection Act, P.L. 115-174, §§ 203, 204 (May 24, 2018).

<sup>7</sup> Section 3(c)(2) of the FDI Act defines an insured depository institution to include any bank or savings association the deposits of which are insured by the FDIC under the FDI Act. 12 U.S.C. 1813(c)(2).

<sup>8</sup> 12 U.S.C. 1813(c)(2), 1851(h)(1).

<sup>9</sup> Economic Growth, Regulatory Relief, and Consumer Protection Act, P.L. 115-174, §§ 203, 204 (May 24, 2018). Section 203 amends section 13(h)(1)(B) of the BHC Act to narrow the scope of the term “banking entity” by excluding certain institutions from the term insured depository institution exclusively for the purposes of section 13. Insured banks and savings associations that qualify for this exclusion for the purposes of section 13 of the BHC Act remain insured depository institutions under section 3(c)(2) of the FDI Act. Additionally, an institution that meets the criteria to be excluded from the definition of insured depository institution under EGRRCPA may still be a banking entity by virtue of its affiliation with another insured depository institution or a company that’s treated as a bank holding company under section 8 of the IBA.

qualify for the exclusion from the term insured depository institution under EGRRCPA's amendments to section 13 of the BHC Act: (i) total consolidated assets; and (ii) trading assets and liabilities as a percentage of total consolidated assets. Consistent with section 203 of EGRRCPA, the interim final rule amends 12 CFR 351.2 to provide that an institution qualifies for this exclusion if it (and every company that controls it) has total consolidated assets equal to or less than \$10 billion, and if it (and every company that controls it) has total consolidated trading assets and liabilities equal to or less than five percent of its total consolidated assets.

As described above, the exclusion is only available if the thresholds regarding total consolidated assets and total consolidated trading assets and liabilities are not exceeded. The Agencies believe that institutions qualifying for the exclusion described above regularly monitor their total consolidated assets and total trading assets and liabilities for other purposes. Therefore, the Agencies do not believe that the test described above will impose any new burden on banking institutions. The Agencies will use available information, including information reported on regulatory reporting forms available to each agency, with respect to whether financial institutions qualify for the exclusion described above.

#### *Covered Fund Name-Sharing Under Section 204 of EGRRCPA*

EGRRCPA amends section 13 of the BHC Act to permit a hedge fund or private equity fund<sup>10</sup> organized and offered by a banking entity to share the same name or a variation of the same name as a banking entity that is an investment adviser to the hedge fund or private equity fund if: 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

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<sup>10</sup> 12 U.S.C. 1851(h)(2). *See also* 12 CFR 44.10(b); 12 CFR 248.10(b); 12 CFR 351.10(b); 17 CFR 255.10(b); 17 CFR 75.10(b).

purposes of section 8 of the IBA;<sup>11</sup> the investment advisor 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.” As originally enacted, the name-sharing restriction prohibited a hedge fund or private equity fund sponsored by a banking entity from sharing a name with the banking entity, including an investment adviser to the fund.

The interim final rule amends 12 CFR Parts 351.10 and 351.11 to conform the FDIC regulations to the changes made by section 204 of the EGRRCPPA. As amended, 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 a banking entity that is an investment adviser to the fund if:

- The investment adviser is not an IDI, a company that controls an IDI, or a company that is treated as a BHC 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 an IDI, a company that controls an IDI, or a company that is treated as a BHC for purposes of section 8 of the IBA; and
- The name does not contain the word “bank”.

#### Effective Date/Request for Comment

The Agencies are issuing the interim final rule without prior notice and the opportunity for public comment and the 30-day delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA).<sup>12</sup> Pursuant to section 553(b)(B) of the APA, general notice and the opportunity for public comment are not required with respect to a rulemaking

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<sup>11</sup> 12 U.S.C. 3106.

<sup>12</sup> 5 U.S.C. 553.

when an “agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”<sup>13</sup> The interim final rule implements sections 203 and 204 of EGRRCPA (effective May 24, 2018), which amend the definition of “banking entity” and modify certain naming restrictions for hedge funds and private equity funds, as described above. In recently proposed revisions to the regulations implementing section 13 of the BHC Act, the Agencies noted that they will not enforce the regulations in a manner inconsistent with section 13 of the BHC Act as revised by EGRRCPA, but would be amending the implementing regulations to take into account the statutory revisions enacted by Congress.<sup>14</sup>

The Agencies believe that the public interest is best served by ensuring that the implementing regulations reflect the statutory amendments enacted by EGRRCPA as soon as possible, and adopting these amendments on an interim final basis will achieve that goal. In addition, the Agencies believe that providing a notice and comment period prior to issuance of the interim final rule is unnecessary, as the interim final rule merely implements the statutory amendments Congress has already made and that are effective. For these reasons, the Agencies believe there is good cause consistent with the public interest to adopt the interim final rule without advance notice and comment. Notwithstanding this good cause finding, the Agencies are inviting public comment on the interim final rule, with a 30-day comment period.

The APA also requires a 30-day delayed effective date, except for (1) substantive rules that grant or recognize an exemption or relieve a restriction; (2) interpretative rules and

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<sup>13</sup> 5 U.S.C. § 553(b)(B).

<sup>14</sup> See 83 FR at 33434 (“The amendments [to section 13 of the BHC Act] took effect upon enactment, however, and in the interim between enactment and the adoption of implementing regulations, the Agencies will not enforce the 2013 final rule in a manner inconsistent with the amendments to section 13 of the BHC Act with respect to institutions excluded by the statute and with respect to the naming restrictions for covered funds.”).

statements of policy; or (3) as otherwise provided by the agency for good cause.<sup>15</sup> The Agencies conclude that, because the interim final rule relieves restrictions by implementing the statutory amendments enacted by EGRRCPA, the interim final rule is exempt from the APA's delayed effective date requirement.<sup>16</sup> Additionally, the Agencies find good cause to publish the interim final rule with an immediate effective date for the same reasons set forth above under the discussion of section 553(b)(B) of the APA.

### Conclusion

FDIC staff recommends that the FDIC Board of Directors adopt the attached interim final rule with an immediate effective date upon publication in the *Federal Register* and authorize its publication in the *Federal Register* for a 30-day, public comment period.

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<sup>15</sup> 5 U.S.C. 553(d).

<sup>16</sup> 5 U.S.C. 553(d)(1).