DATE: June 18, 2019

TO: Board of Directors

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

SUBJECT: ***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 FDIC requests that the FDIC Board of Directors ("Board"), jointly with the Board of Governors of the Federal Reserve System ("Board"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC") (collectively, the "Agencies"), adopt as a final rule, without change, the notice of proposed rulemaking published in the *Federal Register* on February 8, 2019. The final rule would amend the regulations implementing section 13 of the Bank Holding Company Act ("section 13"), also known as the Volcker Rule, in a manner consistent with the statutory amendments made by sections 203 and 204 of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"). Specifically, the final rule would: (1) exclude from section 13's prohibitions and restrictions certain 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; and (2) amend the restrictions applicable to the naming of a hedge fund or private equity fund.

FDIC staff requests that the Board adopt and issue the attached final rule and authorize its publication in the *Federal Register*.

Concur:

Nicholas J. Podsiadly
General Counsel

Background

Section 13[1] 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.[2] Under the statute, authority for developing and adopting regulations to implement the prohibitions and restrictions of section 13 is shared among the Agencies. The Agencies adopted final rules implementing section 13 in December 2013 (the "2013 final rule").[3]

EGRRCPA amended section 13 by modifying the definition of "banking entity" to exclude certain community banks and their affiliates from section 13's restrictions and to permit an investment adviser that is a banking entity to share a name with a hedge fund or private equity fund that the banking entity organizes and offers under certain circumstances.[4] On February 8, 2019, the Agencies published in the *Federal Register* a notice of proposed rulemaking ("the proposal") to revise the 2013 final rule consistent with the EGRRCPA statutory amendments.[5]

[1] 12 U.S.C. § 1851.
[2] *See id.*
[3] *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). In 2018, the agencies proposed amendments to these rules to provide clarity about what activities are prohibited, and to improve supervision and implementation of section 13 of the BHC Act. *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).
[4] *See* Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. 115-174, sections 203, 204 (May 24, 2018). These provisions were effective upon EGRRCPA's enactment.
[5] 84 FR 2778.

Description of the Final Rule

Community Bank Exclusion under Section 203 of EGRRCPA

Section 13 defines "banking entity" to include any insured depository institution, as defined in the Federal Deposit Insurance Act ("FDI Act"),[6] 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. The definition also excludes from the term "insured depository institution" certain insured depository institutions that function solely in a trust or fiduciary capacity, subject to a variety of conditions.[7]

Section 203 of EGRRCPA modified the scope of the term "banking entity" to exclude certain community banks and their affiliates. Specifically, pursuant to section 203, the term "insured depository institution" excludes any institution that does not have, and is not controlled by a company that has: (i) more than $10 billion in total consolidated assets; and (ii) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5 percent of total consolidated assets. Therefore, an insured depository institution is excluded from section 13's particular definition of "insured depository institution" if it and each of its affiliated insured depository institutions meets the conditions of the statutory exclusion.[8] To the extent that such an institution is excluded from section 13's

[6] 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).

[7] 12 U.S.C. 1813(c)(2), 1851(h)(1).

[8] Section 203 amended section 13(h)(1)(B) of the BHC Act 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

particular definition of "insured depository institution," that institution and its affiliates generally are not "banking entities" under section 13, and therefore would not be subject to section 13's prohibitions.

For purposes of implementing section 203 of EGRRCPA, the Agencies proposed to modify the definition of "insured depository institution" in section 351.2(r) of the 2013 final rule. Under the proposal, an insured depository institution would need to satisfy two conditions to qualify for the exclusion from the definition of "insured depository institution." First, the insured depository 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 insured depository institution, and every entity that controls it, must be equal to or less than five percent of its total consolidated assets

Trade associations representing large commercial banks, community banks, and credit unions generally supported the Agencies' proposal to implement the community bank relief provision under section 203 of EGRRCPA.[9] Some commenters cited, among other considerations, the statute's plain meaning, legislative history, and policy considerations for their support of the proposal.[10] Certain other commenters suggested that section 203 extends relief to firms with *either* $10 billion or less in total consolidated assets *or* trading assets and liabilities equal to 5 percent or less of total consolidated assets.[11] Under these commenters' view of section 203, many banks with total consolidated assets well over $10 billion, including certain

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another insured depository institution or a company that is treated as a bank holding company under section 8 of the IBA.

[9] *See* American Bankers Association; Independent Community Bankers of America; National Association of Federally-Insured Credit Unions; California Bankers Association.

[10] LosHuertos and Mount; NAFCU.

[11] *See* Competitive Enterprise Institute; Competitive Enterprise Institute *et al.*; Luetkemeyer; Matthew Thomas.

global systemically important banks with over $250 billion in total consolidated assets, would be exempt from section 13.

Although these comments were fully considered, the final rule would not extend the exclusion under section 203 of EGRRCPA to institutions with total consolidated assets in excess of $10 billion. The plain meaning and structure of the statutory language requires an institution to satisfy both criteria to qualify for the exclusion, and the approach taken by the final rule is consistent with the congressional intent related to the enactment of EGRRCPA, and with the statute as a whole. Section 203 of EGRRCPA is intended to provide relief from the requirements of section 13 for community banks rather than large banking organizations with large volumes of securities trading operations and covered fund activities. As aligned with the statute, under the revised definition, an insured depository institution must satisfy two conditions for it and its affiliates to qualify for the exclusion. First, the insured depository 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 insured depository institution, and every entity that controls it, must be equal to or less than five percent of its total consolidated assets.

Staff of the FDIC recognizes that certain commenters have asserted that the exclusion under section 203 of EGRRCPA extends to institutions with total consolidated assets in excess of $10 billion. However, the statute requires an institution to satisfy both criteria to qualify for the exclusion and it is staff's view that this approach is most consistent with the statutory language of EGRRCPA, the congressional intent behind the statute, and the structure of the statute as a whole.

Section 203 of EGRRCPA is entitled "Community bank relief," and numerous floor statements made by senators contemporaneously with passage of the legislation in the Senate on

a bipartisan basis indicated that section 203 was only intended to exclude community banks and their affiliates.[12] Moreover, the Senate Banking Committee's summary of section 203 describes it as exempting banking entities that have total consolidated assets of $10 billion or less and total trading assets and trading liabilities that are five percent or less of total consolidated assets.[13] For these reasons, the final rule would adopt without change the proposed revisions to section 13's insured depository institution and banking entity definitions.

Covered Fund Name-Sharing Under Section 204 of EGRRCPA

Consistent with the proposal, the final rule would modify the name-sharing restriction in section 351.11(a)(6)(i) of the 2013 final rule to conform that restriction to section 204 of EGRRCPA. Pursuant to this change, 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, subject to the conditions specified in the statute.[14] These conditions require that 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,[15] and that the investment adviser's name does not contain the word "bank."[16]

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[12] *See, e.g.*, 164 Cong. Rec. S1696 at S1701, S1720, S1724–25 (Mar. 14, 2018).

[13] *See* S. 2155, Section-By-Section, as Passed by Senate, United State Senate Committee on Banking and Urban Affairs (March 14, 2018).

[14] EGRRCPA, section 204. While the statute applies these restrictions and conditions to "hedge funds" and "private equity funds," the 2013 final rule applies to "covered funds," as defined in section 351.10 of the regulation. *See supra* footnote [12].

[15] 12 U.S.C. 1851(d)(1)(G)(vi)(I); 12 U.S.C. 1851(d)(1)(G)(vi)(II).

[16] 12 U.S.C. 1851(d)(1)(G)(vi)(III). The requirement that the name not contain the word "bank" was included in the name-sharing restriction by section 204 of EGRRCPA but already is a condition under the 2013 final rule. Accordingly, the Agencies did not make any additional modifications to the rule to reflect this condition.

These revisions to the 2013 final rule would conform the final rule to the statutory language of section 204 of EGRRCPA. Some commenters asked for relief from the name-sharing restriction if required or expected by foreign regulators to share the same name or a variation of the same name with a fund manager that in turn shares the same name or a variation of the same name with a banking entity affiliate,[17] but section 204 of EGRRCPA did not provide such an exclusion. Accordingly, the final rule would not adopt this change to the name-sharing restriction, and the final rule would implement section 204 as proposed.

Conclusion

FDIC staff requests that the Board adopt the attached final rule and authorize its publication in the *Federal Register*.

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[17] ABA; IAA.