

DATE: December 18, 2018

MEMORANDUM TO: Board of Directors

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

SUBJECT: *Notice of Proposed Rulemaking:* Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

Recommendation: Staff recommends that the FDIC Board of Directors approve the attached interagency Notice of Proposed Rulemaking (“NPR”) to amend the regulations implementing section 13 of the Bank Holding Company Act in a manner consistent with the statutory amendments made pursuant to sections 203 and 204 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. Specifically, the statutory amendments: (1) exclude certain institutions that have total consolidated assets equal to \$10 billion or less and that have total consolidated 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 to permit an investment adviser that is a banking entity to share a name with the fund under certain circumstances.

If approved, the NPR will be issued jointly by the FDIC, 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”). The Agencies would issue this NPR in the *Federal Register* with a 30-day public comment period.

Concur:

Charles Yi
General Counsel

Background

Section 13 of the Bank Holding Company Act of 1956 (“BHC Act”),¹ 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.²

Under the section 13 of the BHC Act, authority for adopting regulations to implement the prohibitions and restrictions of section 13 of the BHC Act is shared among the Agencies.³ The Agencies adopted final rules implementing section 13 of the BHC Act in December 2013.⁴

The Economic Growth, Regulatory Relief, and Consumer Protection Act (“EGRRCPA”), enacted on May 24, 2018, amended section 13 of the BHC Act to exclude certain small community banking entities and to permit a banking entity to share a name with a hedge fund or private equity fund that it organizes and offers under certain circumstances.⁵

The Agencies are proposing to amend the final rules in a manner consistent with the

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

² See 12 U.S.C. 1851.

³ 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 (“IBA”), 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.

⁴ 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 recently proposed amendments to the final 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).

⁵ See Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. 115-174, §§ 203, 204 (May 24, 2018).

statutory amendments made by EGRRCPA.

Description of the Notice of Proposed Rulemaking

Community Bank Exclusion under Section 203 of 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”),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 IBA, and any affiliate or subsidiary of such entity (subject to certain exclusions).⁷ EGRRCPA modifies the scope of the term “banking entity” to exclude certain community banking organizations and their affiliates (“community bank exclusion”).⁸

Pursuant to section 203 of EGRRCPA, the term “insured depository institution,” as used in the definition of “banking entity,” does not include an 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 five percent of total consolidated assets. For purposes of implementing section 203 of EGRRCPA, the NPR amends 12 CFR § 351.2 by modifying the definition of “insured depository institution” in 12 CFR § 351.2(r). Under the

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 of EGRRCPA 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 is treated as a bank holding company under section 8 of the IBA.

proposal, an insured depository institution would need to satisfy two conditions to qualify for the community bank 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.

The community bank exclusion would be available only if both the threshold regarding total consolidated assets and the threshold regarding total consolidated trading assets and liabilities are not exceeded.⁹ The Agencies believe that institutions qualifying for the community bank exclusion regularly monitor their total consolidated assets and total trading assets and liabilities. Therefore, the Agencies do not believe that the requirements for the community bank exclusion in this NPR would impose any new burden on banking entities. Rather, the Agencies would expect to use available information, including information reported on regulatory reporting forms available to each Agency, with respect to whether banking entities qualify for the community bank exclusion.

Covered Fund Name-Sharing Under Section 204 of EGRRCPA

Prior to the enactment of EGRRCPA, section 13 provided that a banking entity (or an affiliate of the banking entity), including an investment advisor, that organized and offered a hedge fund or private equity fund could not share the same name or a variation of the same name with the fund (“name-sharing restriction”).¹⁰ Section 204 of EGRRCPA amended the name-

⁹ EGRRCPA did not amend the definition of “banking entity” as it relates to a company that is treated as a bank holding company for purposes of section 8 of the IBA. Therefore, the community bank exclusion does not apply to a foreign banking organization with a U.S. branch or agency, which continues to be subject to the prohibitions in section 13 of the BHC Act.

¹⁰ 12 U.S.C. 1851(d)(1)(G)(vi) (2017).

sharing restriction in section 13 of the BHC Act to permit a hedge fund or private equity fund¹¹ 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: (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 for purposes of section 8 of the IBA;¹² (2) the investment advisor does not share the same name or a variation of the same name with any such entities; and (3) the name does not contain the word “bank.” The NPR would amend 12 CFR §§ 351.10 and 351.11 to conform the FDIC regulations to the changes made by section 204 of EGRRCPA, as described above.

Conclusion

FDIC staff recommends that the FDIC Board of Directors approve the attached interagency NPR and authorize its publication in the *Federal Register* for a 30-day, public comment period.

Staff Contacts:

RMS

Bobby R. Bean ext. 8-6705
Andrew C. Carayiannis ext. 8-6692
Brian J. Cox ext. 8-7007

Legal

Michael B. Phillips ext. 8-3581
Benjamin J. Klein ext. 8-7027
Annmarie H. Boyd ext. 8-3714

¹¹ 12 U.S.C. 1851(h)(2). *See also* 12 CFR 44.10(b) (OCC); 12 CFR 248.10(b) (Board); 12 CFR 351.10(b)(FDIC); 17 CFR 255.10(b)(SEC); 17 CFR 75.10(b)(CFTC).

¹² 12 U.S.C. 3106.