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Agencies Finalize Volcker Rule Amendments

Introduction

In 2018, President Trump signed the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Growth Act") into law. The Growth Act significantly amended two aspects of the Volcker Rule:[1] (1) creating an exemption for community banks, and (2) increasing opportunities to have funds and their investment advisers co-brand by sharing names.[2]

On Tuesday, July 9, 2019, five federal agencies,[3] (the "Agencies"), adopted new final rules to implement the Growth Act's changes to the Volcker Rule by conforming each agency's version of the Volcker Rule regulations to the Growth Act.[4] The Agencies proposed the new rules on February 8, 2019 and received industry comments, as per the Administrative Procedure Act, before being finalized.[5] The rules were ultimately adopted as proposed, without any changes.

Community Bank Exception

- By excluding community banks from the definition of an insured depository institution ("IDI"), the Growth Act allowed such banks, i.e., those with less than $10 billion in total consolidated assets, to hold trading assets and liabilities of up to 5% of their total consolidated assets, despite the limitations imposed on the holding of certain of such assets by banking entities generally, pursuant to the Volcker Rule.[6]

- During the notice-and-comment period, some commenters made an argument based on a double negative in the wording of the Growth Act that banks only need to satisfy either (a) the $10 billion consolidated asset ceiling or (b) the 5% trading asset percentage limitation to be exempt from the

1 Section 13 of the Bank Holding Company Act, codified at 12 U.S.C. § 1851. See 12 C.F.R. Part 248 (final regulations).

2 Gerard Comizio, Jessica Forbes, and Nathan S. Brownback, *Coming Financial Regulatory Relief Law: Impact of Changes to the Volcker Rule*, 18/05/22 Fried Frank Financial Services Client Alert 1 (2018), https://www.friedfrank.com/siteFiles/Publications/FFServicesAlertComingFinancialRegulatoryReliefLawImpactofChanges052218.pdf, [hereinafter: *Coming Financial Regulatory Relief Law*].

3 The five federal agencies are: the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

4 Agencies, Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 35008, 35008 (July 22, 2019), https://www.govinfo.gov/content/pkg/FR-2019-07-22/pdf/2019-15019.pdf, [hereinafter "*Revisions to Prohibitions and Restrictions*"].

5 *Id.* at 35009.

6 *Id.*

Volcker Rule.[7] However, the Agencies interpreted the Growth Act such that both the $10 billion asset ceiling and 5% trading assets/liabilities cap must be satisfied for a community bank to qualify for the exception.[8]

- The final rules issued by the Agencies clarified that foreign banking organizations ("FBOs") with offices or branches in the US with less than $10 billion in consolidated assets will not be able to rely on the exception.[9]

- Several commenters asked the Agencies to clarify how a community bank can demonstrate that it meets the 5% trading assets/liabilities threshold. The Agencies specifically clarified that either quarterly call reports or FR Y-9C filings (depending on the entity involved) may be used to determine whether the 5% trading assets and liabilities threshold has been met.[10] This means that the normal mechanisms employed to determine the amount of trading assets and liabilities for call report purposes also apply for purposes of demonstrating compliance with the 5% threshold.

- By requiring banking entities to demonstrate compliance with the threshold using their last quarterly call report data, the Agencies have effectively created a grace period of up to three months for community banks, during which they can theoretically exceed the threshold of 5% of consolidated assets in trading assets and liabilities, though we note that a banking entity in such position would not be in technical compliance with the Volcker Rule during such period.

- Despite requests from commenters for the Agencies to clarify which exact assets should be classified as trading assets, the final rules stated that the "question of how to classify specific types of assets…on the call report and FR Y-9C is fact-specific" and referred to the instructions for the relevant forms.[11]

- Interestingly, despite the advantages that the new rules will create for community banks, large commercial banks generally supported the changes as well.[12]

Co-Branding by Funds and Their Advisers Through Name Sharing

- With respect to name sharing, the Agencies have adopted the language used in the Growth Act. Specifically, banking entities may share their names with covered funds if: (1) the banking entity in question is an investment adviser to the fund; (2) the banking entity is not an IDI, a company that controls a depository institution, such as a bank holding company ("BHC"), or an FBO treated as a BHC for purposes of the International Banking Act of 1978 (that is, the banking entity must only be classified as a banking entity pursuant to the Volcker Rule because it is an affiliate of a bank or other IDI); (3) the banking entity does not share its name or a variation thereof with an IDI, BHC, or FBO; and (4) the banking entity's name does not include the word "bank."[13]

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7 *Id.*

8 *Id*. (among other things, the Agencies cited the heading of the relevant statutory section–"Community Bank Relief"–to support the finding).

9 *Id.*

10 *Id.* at 35010.

11 *Id.*

12 *Id.* at 35009.

13 *Coming Financial Regulatory Relief Law* at 2.

- During the comment period, some commenters asked for relief from the name sharing restrictions in condition (3) above for banking entities that are required by foreign law to share names with fund managers.[14] Ultimately, no relief was granted in this situation, at least not as part of this rulemaking.[15]

Conclusion

The final rules adopted by the Agencies closely reflect the language of the Growth Act, with only clarifications in some areas. Banking entities should be aware that community banks–defined as those under $10 billion in total consolidated assets and 5% trading assets and liabilities–should use the definition of trading assets and liabilities from their call report and FR Y-9C filings to determine whether they are below the 5% threshold. Another important takeaway is that foreign banking organizations are not eligible for the community bank exception. Lastly, the changes to the Volcker Rule's name sharing restrictions mean that banking entities that are investment advisers may share their names with covered funds if they meet the four conditions listed above.

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[14] *Revisions to Prohibitions and Restrictions* at 35011.

[15] *Id.*