Fried Frank Financial Services
Client Alert™

Coming Financial Regulatory Relief Law: Impact of Changes to the Volcker Rule

Introduction

Recently, leaders of the House of Representatives indicated that the House will vote this week on a Senate bill, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Bill"),[1] without any changes from the Senate version, and that the Bill is likely to pass.[2] If signed by President Trump, as expected, the resulting law would represent the first significant deregulatory piece of legislation amending the Dodd-Frank Act.

The Bill is wide-ranging and makes changes to a number of financial services laws,[3] including the Volcker Rule.[4] While the major provisions of the Volcker Rule would remain unchanged, the Bill makes three notable changes to (or affecting) the Volcker Rule: (1) an exemption for community banks, (2) increased opportunities to have funds and their investment advisers co-brand by sharing names, and (3) an expansion of the scope of the Section 3(c)(1) exemption of the Investment Company Act for small venture capital funds.

Community Bank Exemption

The Bill would create a new exemption to the Volcker Rule's banking entity definition[5] for any bank or bank holding company ("BHC") with $10 billion or less in consolidated assets, so long as such banking entity's total trading assets or liabilities do not exceed 5% of the banking entity's total consolidated assets. This exemption would not only permit community banks to engage in Volcker-prohibited activities such as

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1 S. 2155, as passed by the Senate on Mar. 14, 2018, https://www.congress.gov/bill/115th-congress/senate-bill/2155/text.

2 *See, e.g.*, John Heltman, House reg relief vote now in sight, AMERICAN BANKER (May 15, 2018), https://www.americanbanker.com/news/house-reg-relief-vote-now-in-sight; Susan Cornwell & Katanga Johnson, House to take up Dodd-Frank rewrite 'soon', says Speaker Ryan, REUTERS (May 8, 2018), https://www.reuters.com/article/us-usa-house-ryan-banking/house-to-take-up-dodd-frank-rewrite-soon-says-speaker-ryan-idUSKBN1I92I7.

3 The Bill's provisions include, among others, (1) raising the threshold for enhanced prudential standards required under Dodd-Frank – the so-called "SIFI threshold" – from $50 billion to $250 billion, (2) reducing stress test requirements, (3) adjusting leverage and liquidity coverage ratio requirements, (4) exempting community banks from certain capital rules, (5) expanding the pool of "qualified mortgages" under the Truth in Lending Act, (6) certain securities law changes designed to encourage capital formation, (7) instituting consumer protection measures regarding identity theft and data security, and (8) certain protections for borrowers and cosigners of student loans. These provisions, among other things, will be the topic of an upcoming Fried Frank client memo.

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

5 Section 13(h)(1) of the Bank Holding Company Act, codified at 12 U.S.C. § 1851(h)(1). *See* 12 C.F.R. § 248.2(c).

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proprietary trading and investments in covered funds[6] – though few community banks engaged in these activities at significant scale even before the Volcker Rule – but would also exempt such community banks from having to maintain Volcker Rule compliance programs.[7] The community banks' industry association has suggested that such compliance programs are an unnecessary and significant drain on bank resources.[8]

Co-branding by Funds and Their Advisers through Name Sharing

The Bill would also modify the current prohibition on banking entities "sponsoring" covered funds by sharing the same name or a variation of the same name with a covered fund for corporate, marketing, promotional or other purposes.

The Bill would allow banking entities to share their names with covered funds, provided that:

- The banking entity in question is an investment adviser to the fund,
- The banking entity is not an insured depository institution, a company that controls an insured depository institution, or an entity treated as a BHC for purposes of the International Banking Act of 1978,
- The banking entity does not share the same name or a variation of the same name as any of the three categories of entity described in the bullet above, and
- The banking entity's name does not include the word "bank."

The impact of this change may be demonstrated through this illustration: a banking organization includes a subsidiary national bank, ABC, N.A., of a BHC, ABC Holdings. ABC Holdings has another subsidiary, outside the chain of ownership of ABC, N.A., that is an asset management firm called XYZ Capital Management. If the Bill becomes law, XYZ Capital Management may share all or part of its name with afund – say, XYZ Fund I – that relies on Section 3(c)(1) or (7) of the Investment Company Act, if XYZ Capital Management is an investment adviser to the fund. It is currently prohibited from doing so because XYZ Capital Management is a banking entity by virtue of being an affiliate of ABC Holdings and ABC, N.A., and

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6 "Covered funds" – the Volcker Rule's term for certain investment funds with respect to which banking entities are restricted from investment, sponsorship, and certain transactions – include (1) funds that are not registered investment companies pursuant to exemptions contained in Section 3(c)(1) or 3(c)(7) of the Investment Company Act, (2) certain commodity pools under the Commodity Exchange Act, and (3), with respect to a banking entity that is or is controlled by a U.S. banking entity, non-U.S. funds that invest in securities for resale or other disposition or that otherwise trade in securities.

7 12 C.F.R. Part 248 Subpart D.

8 The trade association, ICBA, said, in a letter to the Office of the Comptroller of the Currency:

> In some instances, [community banks] have had to hire consultants and attorneys to figure out if they are even subject to the rule. For instance, even though bona fide hedging activities are considered exempt under the rule, community banks have had to hire consultants when engaging in interest rate swaps and other hedging activity to make sure that they comply with the rule. Community banks that routinely purchase and sell government securities and municipal securities have also had to use consultants to ensure that they are not technically engaging in proprietary trading under the definition of the rule.

Independent Community Bankers of America, Comment on Proprietary Trading and Certain Interest [sic] in and Relationships with Covered Funds (Volcker Rule) 12 CFR Part 44 (Docket ID OCC-2017-0014) (Sept. 19, 2017), https://www.icba.org/docs/default-source/icba/advocacy-documents/letters-to-regulators/2017/cl091917.pdf?sfvrsn=0.

because sharing a name with a covered fund constitutes prohibited "sponsorship" of that fund under the Volcker Rule.[9]

Expansion of 3(c)(1) Exemption: Not Volcker Rule Regulatory Relief for Certain Venture Capital Funds

The Bill would expand the scope of the exemption provided in Section 3(c)(1) of the Investment Company Act to allow certain small venture capital funds – those with no more than $10 million in aggregate capital contributions and uncalled committed capital – with no more than 250 investors (rather than the current 100) to rely on the exemption. Because this change would expand the scope of the Section 3(c)(1) exemption from the Investment Company Act, any fund using this exemption would be a covered fund under the Volcker Rule.

Only the smallest venture capital funds would be able to take advantage of a newly-expanded Section 3(c)(1), given the $10 million cap, but any venture capital fund that does so should consider the fact that reliance on Section 3(c)(1) would make the venture capital fund a covered fund pursuant to the Volcker Rule.

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9 *See* 12 C.F.R. § 248.10(a)(1), 10(d)(9)(iii).

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This Alert is not intended to provide legal advice, and no legal or business decision should be based on its content. If you have any questions about the contents of this Alert, please call your regular Fried Frank contact or the attorney listed below:

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