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Regulatory Rollback: First Set of Volcker Rule Reforms Finalized

Attorneys
Mark V. Nuccio
Gideon Blatt

On July 9, 2019, the five federal financial regulatory agencies issued a final rule (the "Rule") to, *inter alia*, revise the Volcker Rule's name-sharing restrictions applicable to bank-affiliated hedge funds and private equity funds and exclude certain community banks from the Volcker Rule.[1] The Rule is consistent with the statutory amendments made pursuant to sections of the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") and finalizes the changes as proposed in EGRRCPA in order to conform the regulations to the statutory revisions.[2]

While the Rule will have a limited effect on the banking industry, other proposed revisions to the Volcker Rule regulations remain pending and, if adopted, would have a more significant impact on large banking institutions.

Revision of Name-Sharing Restrictions:

Consistent with section 204 of EGRRCPA, the Rule revises 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. Prior to enactment of EGRRCPA, the Volcker Rule provided that a banking entity (or an affiliate of the banking entity), including an investment adviser, that organized and offered a hedge fund or private equity fund[3] could not share the same name or a variation of the same name with the fund (the "name-sharing restriction").[4]

The name-sharing restriction now permits a hedge fund or private equity fund 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 ("BHC") for purposes of section 8 of the International Banking Act of 1978 ("IBA"); (2) the investment adviser does not share the same name or a variation of the same name with any such insured depository institution or company treated as a BHC for purposes of the IBA; and (3) the name does not contain the word "bank."[5] By following the new rule, this change will allow non-bank investment advisory affiliates that have identities separate and distinct from their parent banking companies to market and sell funds under their own brand names.

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[1] *See* Final Rules, Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190709b1.pdf.

[2] *See* Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. 115-174, sections 203, 204 (May 24, 2018). EGRRCPA marked the first set of much anticipated roll-backs of the Dodd-Frank Act of 2010. Although heralded in the media as a dramatic step away from regulatory reforms introduced by Dodd-Frank, the changes included in EGRRCPA generally have the greatest impact on small banks. The provisions in the Rule became effective upon enactment of EGRRCPA.

[3] *See* 12 U.S.C. 1851(h)(2) (defining "hedge fund" and "private equity fund"). *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) (defining "covered fund" for purposes of the 2013 Volcker Rule final rule).

[4] *See* 12 U.S.C. 1851(d)(1)(G)(vi) (2017).

[5] The Rule also finalizes conforming changes to the definition of "sponsor." The definition of the term "sponsor" includes a banking entity that shares the same name or a variation of the same name with a fund, for corporate, marketing, promotional, or other purposes, except as permitted under the name-sharing restriction as amended by EGRRCPA. The Rule does not, however, provide an exclusion allowing banking entities to share a name with a covered fund if required or expected to by foreign regulators because the changes are limited to implementing section 204 of EGRRCPA as proposed.

Exclusion of Community Banks:

The Rule excludes from the Volcker Rule prohibitions and restrictions certain firms 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.[6]

Section 203 of EGRRCPA, entitled "Community bank relief," modified the scope of the term "banking entity" to exclude certain community banks and their affiliates. Specifically, under section 203, the term "insured depository institution" no longer includes 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.[7] Thus, an insured depository institution and its affiliates generally are not "banking entities" if the insured depository institution and each affiliated insured depository institution meets the statutory exclusion. This cracks opens an opportunity for community banks to have small trading books and sponsor and invest in covered funds, subject to limitations provided in the Rule.

For further information about how the issues described in this Alert may impact your interests, please contact Mark Nuccio, Gideon Blatt or your regular Ropes & Gray contact.

[6] A bank or savings association seeking to determine its eligibility for the exclusion may use its most recent quarterly Consolidated Report of Condition and Income (call report) as the source of data for its consolidated assets and its total trading assets and liabilities at the bank or savings association level. Similarly, a banking organization may use the most recent filing of the Federal Reserve Board's FR Y-9C by its holding company as the source of data about the consolidated assets and total trading assets and liabilities of the companies controlling the bank or savings association.

[7] Exempt community banks will continue to be examined by the banking agencies for compliance with applicable laws and regulations, including the requirement under applicable banking laws and regulations that they operate in a safe and sound manner.