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February 10, 2020

Legal Update

US Agencies Proposed Revisions to Volcker Rule Covered Funds Provisions

On January 30, 2020, the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively, the "Agencies") proposed revisions to the covered funds provisions of the Volcker Rule (the "Proposal").[1] The Proposal is intended to address the prohibitions and restrictions regarding covered fund activities in the same way that the Agencies' August 2019 rulemaking primarily focused on the Volcker Rule's restrictions on proprietary trading.[2]

The Agencies intend for the Proposal to clarify, streamline, and ease the compliance burden of the covered funds provisions of the Volcker Rule by:

- Codifying foreign excluded fund relief for non-US banking entities;
- Incorporating some Section 23A exemptions into the "Super 23A" restrictions;
- Easing the compliance burden for loan securitizations, foreign public funds, and small business investment companies;
- Creating four new exclusions for banking entities to invest in or sponsor credit funds, venture capital funds, customer facilitation funds, and family wealth management vehicles;
- Narrowing the scope of the definition of ownership interest; and
- Clarifying the treatment of parallel direct investments by a banking entity in the same underlying investments as a sponsored covered fund.

While the proposed revisions address many of the implementation and compliance issues raised by the current regulation, the Proposal also requests comment on the proposed revisions, as well as other potential changes that the Agencies are considering. The comment period on the Proposal will end on April 1, 2020. We have summarized the proposed revisions below.

I. Exemptions for Foreign Excluded Funds

The Proposal would create new exemptions to the prohibitions against proprietary trading and covered fund activities (as opposed to exclusions) for qualifying foreign excluded funds. Currently, a non-US fund that is offered

and sold outside of the United States could be subject to the prohibitions against proprietary trading and engaging in covered fund activities as a result of being excluded from the definition of a covered fund. This situation would occur if a non-US banking entity controlled the excluded fund (e.g., based on common corporate governance, such as where the fund's sponsor selects the majority of the fund's directors or trustees), with the result that the excluded fund would itself be considered a banking entity and therefore subject to the Volcker Rule's proprietary trading and covered fund restrictions.

The federal banking agencies had addressed this issue by announcing in a joint policy statement that they would not take enforcement action against a non-US banking entity based on the activities and investments of its foreign excluded funds that met certain criteria, referred to as "qualifying foreign excluded funds."[3] The Proposal would codify this regulatory relief by creating exemptions for such funds using the same criteria as the policy statement. Specifically, the exemptions would be available to a banking entity (i.e., the foreign excluded fund) that:

- Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;
- Would be a covered fund if the entity were organized or established in the United States, or is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in financial instruments for resale or other disposition or otherwise trading in financial instruments;
- Would not otherwise be a banking entity except by virtue of the acquisition or retention of an ownership interest in, sponsorship of, or relationship with the entity, by another banking entity that meets the following: (i) the banking entity is not organized, or directly or indirectly controlled by a banking entity that is organized, under the laws of the United States or of any State; and (ii) the banking entity's acquisition or retention of an ownership interest in or sponsorship of the fund meets the requirements for permitted covered fund activities and investments solely outside the United States, as provided in Section __.13(b);
- Is established and operated as part of a bona fide asset management business; and
- Is not operated in a manner that enables the foreign banking entity to evade the requirements of the Volcker Rule.

II. Modifications to Existing Exclusions

A. LOAN SECURITIZATIONS

The existing loan securitization exclusion ("LSE") excludes certain loan securitization vehicles[4] from the definition of covered funds if they hold only loans and certain loan-related rights and assets. The Proposal would relax two key eligibility criteria to rely on the LSE. First, the Proposal would permit a qualifying loan securitization to hold non-loan assets (e.g., corporate bonds or derivatives)of no more than 5 percent of the securitization's total assets.[5] This partially responds to industry feedback that historically such vehicles incorporated "bond buckets" and other types of non-loan assets into the pool of securitized loan assets. Second, the Proposal would codify an FAQ issued by the staff of the Agencies in 2014, which indirectly addressed a typographical error in the regulation by stating that, while a servicing asset may or may not be a security, if the servicing asset is a security, it must be a permitted security under the exclusion.[6] The definition of "cash equivalents" in the FAQ relating to the

definition of "permitted security" also would be codified by the Proposal.[7]

The Proposal does not explicitly clarify whether the LSE may be used to hold operating leases or lease residuals in a qualifying loan securitization. The preamble suggests that the Agencies believe that such a clarification is unnecessary because leases are already included in the definition of "loans" and thus are already permitted assets under the current exclusion, but does not explicitly address the distinction between capital and operating leases. Further, nothing in the Proposal would explicitly address the holding of underlying leased assets (including monetized residuals) in securitizations.

B. FOREIGN PUBLIC FUNDS

The Proposal would modify the current exclusion for foreign public funds by updating relevant definitions, requirements, and limitations. Currently, a "foreign public fund" is defined as any investment fund that is organized outside of the United States, the ownership interests of which are (1) authorized to be sold to retail investors in the fund's home jurisdiction and (2) sold predominantly through one or more public offerings outside of the United States. The Proposal would replace these requirements with a single requirement that ownership interests in the putative covered fund are offered and sold through at least one public offering outside of the United States.

To help ensure that funds qualifying for the exclusion are sufficiently similar to US registered investment companies, the Proposal would modify the definition of "public offering" to add a new requirement that the distribution be subject to substantive disclosure and retail investor protection laws or regulations in the jurisdiction where it is made. Additionally, the Proposal would limit the requirement that distributions comply with all applicable requirements in the jurisdiction where it is made to only apply to instances when a banking entity acts as the investment manager, investment adviser, commodity trading advisor, commodity pool operator, or sponsor of the fund, addressing potential difficulties faced by a banking entity investing in a fund sponsored by a third-party.

The proposed revisions also would eliminate the limitation on selling ownership interests of the foreign public fund to employees (other than senior executive officers) of the sponsoring banking entity or fund (or affiliates of the banking entity or fund). The limits on the sale of ownership interests to directors or senior executive officers of the sponsoring banking entity or the fund (or their affiliates) would remain in place.

C. PUBLIC WELFARE FUNDS AND SMALL BUSINESS INVESTMENT COMPANIES

1. Public Welfare Funds

The Proposal requests information on whether any changes should be made to clarify that all excluded public welfare investment funds, under any agency's regulation, are excluded from the covered funds restrictions of the Volcker Rule. In particular, the Proposal poses several questions related to the interactions and potential incongruences between qualifications for the public welfare exclusion and the Community Reinvestment Act ("CRA"). For example, the Agencies asked if they should "establish a separate exclusion for CRA-qualified investments or incorporate such an exclusion into the exclusion for public welfare investments."

Some of the federal banking agencies are currently considering revisions to CRA regulations. The FDIC and OCC recently issued a proposed rulemaking that, if adopted, would extensively update the agencies' respective CRA regulations.[8] Given the Proposal's apparent focus on harmonizing the public welfare exclusion with the CRA, any revisions

to the latter will likely have a material impact on the exclusion.

2. Small Business Investment Companies

The Proposal would revise the small business investment companies ("SBICs") exclusion to clarify how the exclusion would apply to SBICs that surrender their license during wind-down phases. The revision would specify that the exclusion for SBICs applies to an issuer that was an SBIC that has voluntarily surrendered its license to operate as a small business investment company in accordance with 13 C.F.R. § 107.1900 and does not make new investments (other than investments in cash equivalents) after such voluntary surrender. The expanded exclusion, however, would not be available for an SBIC that has had its license revoked.

Rural business investment companies ("RBICs") and qualified opportunities funds (established under the "opportunity zone" program from the Tax Cuts and Jobs Act) ("QOFs") were not mentioned in the proposed revisions but did receive attention from the Agencies in their request for comments. Specifically, question 21 asks for information on the status of RBICs under the current exclusions and the potential merits of creating an explicit exclusion for RBICs, and question 22 poses similar questions regarding QOFs.

III. New Covered Fund Exclusions

A. CREDIT FUNDS

The Proposal would create a new exclusion for credit funds that make loans, invest in debt, or otherwise extend the type of credit that banking entities may provide directly under applicable banking law. A "credit fund" would be defined as an issuer whose assets consist solely of: (i) loans; (ii) debt instruments; (iii) related rights and other assets that are related or incidental to acquiring, holding, servicing, or selling loans, or debt instruments; (iv) certain interest rate or foreign exchange derivatives.

The exclusion would be subject to certain limitations and conditions. Under the Proposal, a credit fund could not (i) engage in activities that would constitute proprietary trading, as defined in Section __.3(b)(1)(i) of the Volcker Rule[9] (as if the fund were a banking entity); or (ii) issue asset-backed securities.[10] Additionally, the availability of the credit fund exclusion would be subject to compliance with the following conditions:

- If a banking entity sponsored or served as an investment adviser or commodity trading advisor to a credit fund, the banking entity would be required to provide disclosures specified in Section __.11(a)(8) to any prospective and actual investor (e.g., that losses will be borne solely by investors and not the banking entity and that the ownership interests in the fund are not insured by the FDIC and are not deposits, obligations of, or endorsed or guaranteed by the banking entity, among others) and ensure that the activities of the credit fund are consistent with safety and soundness standards[11] that are substantially similar to those that would apply if the banking entity engaged in the activities directly;
- A banking entity would not be permitted to rely on the credit fund exclusion if (i) it guarantees, assumes, or otherwise insures the obligations or performance of the fund, or (ii) the fund holds any debt securities, equity, or rights to receive equity that the banking entity would not be permitted to acquire and hold directly;
- A banking entity's investment in and relationship with a credit fund would be required to comply with the "Super 23A" restrictions in Section __.14 (except the banking entity would be permitted to acquire and retain any ownership interest in the credit fund), and the prudential

limitations in Section __.15 regarding material conflicts of interest, high-risk investments, and safety and soundness and financial stability, in each case as though the credit fund were a covered fund;

- A banking entity's investment in, and relationship with, a credit fund also would be required to comply with applicable safety and soundness standards; and
- A banking entity that invests in or has a relationship with a credit fund would continue to be subject to capital charges and other requirements under applicable banking law.[12]

B. VENTURE CAPITAL FUNDS

The Proposal would create a new exclusion for qualifying "venture capital funds," which it defines as an issuer that meets the definition in Rule 203(1)-1 under the Investment Advisors Act of 1940 and that does not engage in any activity that would constitute proprietary trading (as defined in Section __.3(b)(1)(i) of the Volcker Rule), as if it were a banking entity. In order to rely on the exclusion, any banking entity that acts as a sponsor, investment adviser, or commodity trading adviser to the venture capital fund would be required to provide in writing to any prospective and actual investor the disclosures required under Section __.11(a)(8), as if the venture capital fund were a covered fund, and ensure that the activities of the fund are consistent with safety and soundness standards that are substantially similar to those that would apply if the banking entity engaged in the activities directly.

The proposed exclusion would also require a banking entity's ownership interest in or relationship with a qualifying venture capital fund to comply with the restrictions imposed by Super 23A (discussed below) (except the banking entity could acquire and retain any ownership interest in the fund) and by the prudential backstops, as if the venture capital fund were a covered fund and to be conducted in compliance with, and subject to, applicable banking laws and regulations, including applicable safety and soundness standards. A banking entity that relies on the exclusion would not, directly or indirectly, be permitted to guarantee, assume, or otherwise insure the obligations or performance of the venture capital fund.

The Agencies indicated they are considering an additional restriction on the exclusion to limit it to funds that do not invest in companies that, at the time of the investment, have more than a limited dollar amount of total annual revenue, calculated as of the last day of the calendar year (e.g., $50 million). The Agencies are considering what specific threshold would be appropriate and requested comments on the issue, among others.

C. FAMILY WEALTH MANAGEMENT VEHICLES

The Proposal would create a new exclusion for family wealth management vehicles. Under the proposed exclusion, a "family wealth management vehicle" would include any entity that is not, and does not hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities, provided that (i) if the entity is a trust, the grantor(s) of the entity are all family customers[13] and, (ii) if the entity is not a trust, a majority of the voting interests are owned (directly or indirectly) by family customers and the entity is owned only by family customers and up to three closely related persons[14] of the family customers.

Under the Proposal, this exclusion would be available to a banking entity only if it (or an affiliate):

1. Provides bona fide trust, fiduciary, investment advisory, or commodity trading advisory services to the family wealth management vehicle;
2. Does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such family wealth management vehicle;
3. Complies with the disclosure obligations under Section __.11(a)(8), as if the family wealth management vehicle were a covered fund;
4. Does not acquire or retain, as principal, an ownership interest in the entity, other than up to 0.5 percent of the entity's outstanding ownership interests that may be held by the banking entity and its affiliates for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns;
5. Complies with the Super 23A restrictions and prudential backstops (i.e., Sections __.14(b) and __.15) as if the family wealth management vehicle were a covered fund; and
6. Complies with the low-quality assets prohibition of Regulation W (12 C.F.R. § 223.15(a)), as if such banking entity and its affiliates were a member bank and the family wealth management vehicle were an affiliate thereof.

D. CUSTOMER FACILITATION VEHICLES

The Proposal would create a new exclusion for customer facilitation vehicles. The proposed exclusion would be available for any issuer that is formed by or at the request of a customer of the banking entity for the purpose of providing such customer (which may include one or more affiliates of such customer) with exposure to a transaction, investment strategy, or other service provided by the banking entity. The condition that vehicles be formed by or at the request of a customer would not preclude a banking entity from marketing its services through the use of customer facilitation vehicles or discussing with its customers prior to formation of the customer facilitation vehicle the potential benefits of structuring such services through a vehicle.

Additionally, a banking entity would be required to satisfy the following conditions to rely on the exclusion for customer facilitation vehicles:

1. All of the ownership interests of the customer facilitation vehicle are owned by the customer (which may include one or more of its affiliates) for whom the vehicle was created, subject to paragraph 2.d. below; and
2. The banking entity and its affiliates:
    a) Maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to such transaction, investment strategy, or service;
    b) Do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the customer facilitation vehicle;
    c) Comply with the disclosure obligations under Section __.11(a)(8), as if the customer facilitation vehicle were a covered fund;
    d) Do not acquire or retain, as principal, an ownership interest in the customer facilitation vehicle, other than up to 0.5 percent of the vehicle's outstanding ownership interests that may be held by the banking entity and its affiliates for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns;

e) Comply with the Super 23A restrictions and prudential backstops (i.e., Section __.14(b) and __.15) as if the customer facilitation vehicle were a covered fund; and

f) Comply with the low-quality assets prohibition of Regulation W (12 C.F.R. § 223.15(a)), as if such banking entity and its affiliates were a member bank and the customer facilitation vehicle were an affiliate thereof.

IV. Exemptions from Super 23A Restrictions

The Volcker Rule generally prohibits a banking entity from entering into a transaction with a covered fund that would be a covered transaction as defined in Section 23A of the Federal Reserve Act (e.g., a loan or extension of credit to an affiliate, or a purchase of or an investment in securities issued by an affiliate). Section 23A of the Federal Reserve Act, as implemented by the Board in Regulation W, includes a number of exemptions from its restrictions that are not currently incorporated by the Volcker Rule. This results in the restrictions under the Volcker Rule (referred to as "Super 23A" because it applies the Section 23A restrictions to a broad set of transactions by nonbank affiliates) applying to a much larger universe of relationships.

A. Exempt Transactions under Section 23A and the Board's Regulation W

The Proposal would permit a banking entity to engage in covered transactions with a related covered fund that would be exempt from the quantitative limits, collateral requirements, and low-quality asset prohibition under Section 23A of the Federal Reserve Act, including transactions that would be exempt pursuant to 12 C.F.R. § 223.42. Such exempt transactions include making correspondent banking deposits, giving credit for uncollected items, and transactions secured by cash or US government securities, among others.

B. Short-term Extensions of Credit and Acquisitions of Assets in Connection with Payment, Clearing, and Settlement Services

The Proposal would permit a banking entity to provide short-term extensions of credit to and purchase assets from a related covered fund, subject to limitations. Such limitations would include:

- Each short-term extension of credit or purchase of assets would have to be made in the ordinary course of business in connection with payment transactions; securities, derivatives, or futures clearing; or settlement services.
- Each extension of credit would be required to be repaid, sold, or terminated no later than five business days after it was originated.
- Each short-term extension of credit must also meet the same requirements applicable to intraday extensions of credit under 12 C.F.R. § 223.42(l)(1)(i) and (ii) as if the extension of credit was an intraday extension of credit, regardless of the duration of the extension of credit.[15]

Additionally, each extension of credit or purchase of assets permitted by these revisions would be required to comply with the prudential backstops.

V. Narrowing of Definition of Ownership Interest

The regulation defines an "ownership interest" in a covered fund as any equity, partnership or other similar interest. An "other similar interest" is defined by reference to a broad list of characteristics, which arguably include certain standard provisions in debt instruments (e.g., the right to vote on a nominated replacement manager upon an investment manager's resignation or removal).

To address this issue, the Agencies proposed (i) clarifying amendments to the definition of "other similar interest" and (ii) creating an express safe harbor for senior loans and senior debt. The Agencies also propose amending the manner in which banking entities must calculate their ownership interests for purposes of complying with the limits for certain exempted covered fund activities.

A. CREDITOR REMEDIES

The Proposal would adjust a parenthetical in the definition of ownership interest to specify that creditors' remedies upon the occurrence of an event of default or an acceleration event include the right to participate in the removal of an investment manager for cause or to nominate or vote on a nominated replacement manager upon an investment manager's resignation or removal.

This proposed revision falls short of what the industry had sought in terms of this prong of the ownership interest definition as it does not expand the realm of creditor remedies that would be excluded from the definition. Rather, it would explicitly identify two types of remedies that are covered by the current exclusion.

Specifically, the modified parenthetical would state that the ownership interest definition "exclude[s] the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event, which includes the right to [i] participate in the removal of an investment manager for cause or to nominate or [ii] vote on a nominated replacement manager upon an investment manager's resignation or removal" (emphasis added). This modification would not expand the scope of what is currently excluded from the definition of ownership interest given that the exclusion of the specified remedies is conditioned upon the occurrence of an event of default or an acceleration event, and these remedies were already understood by the industry to fall within the exclusion if so conditioned.

The questions posed by the Agencies related to this adjustment suggest that a meaningful change to the definition is still possible for the final rule. Specifically, Question 78 of the Proposal asks whether the revision should be expanded to include the right to participate in any removal of an investment manager for cause, or to nominate or vote on a nominated replacement manager upon an investment manager's resignation or removal, whether or not an event of default or an acceleration event has occurred.

B. SAFE HARBOR

The Proposal would create a safe harbor from the definition of ownership interest. Specifically, any senior loan or other senior debt interest that meets all of the following characteristics would not be considered to be an ownership interest under the proposed rule:

- Under the terms of the interest, the holders of such interest do not receive any profits of the covered fund but may only receive: (i) interest payments which are not dependent on the performance of the covered fund; and (ii) fixed principal payments on or before a maturity date;
- The entitlement to payments under the terms of the interest is absolute and may not be reduced because of the losses arising from the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the principal and interest payable; and
- The holders of the interest are not entitled to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of

an event of default or an acceleration event).

The Agencies did not define “senior” in the Proposal, nor did they provide any guidance in the accompanying preamble on how to determine if a particular loan or other debt interest is “senior.” Our initial view is that “senior” is not limited to “most senior” but rather includes those loans or other debt interests that are generally understood as senior in the market for the particular type of transaction. It is possible that certain rules of thumb will develop for identifying “senior” debt interests in the context of a given market. Depending on the context this could mean, for example, a senior loan benefiting from equity subordination, a debt instrument with an investment grade rating, a debt instrument with a 20 percent risk weighting under US regulatory capital rules, or something else entirely. These examples are not definitive or exhaustive, nor do we mean to suggest that a debt interest that falls outside any such rules of thumb will not be “senior”—rather, such an instrument will require an attribute-based analysis to determine it qualifies as “senior” in a given transaction.

Additionally, one of the Agencies’ questions in this section also suggests potential ambiguity. Question 79 requests comments on whether the Agencies should modify the regulation “to clarify that only an interest which has the right to receive a share of the ‘net’ income, gains or profits of the covered fund is an ownership interest.” The implication of this request may raise concerns relative to current industry practice and expectations.

C. FUND INVESTMENT LIMITS

The Proposal would modify the implementing regulations to better align the manner in which a banking entity calculates the aggregate fund limit and covered fund deduction with the manner in which it calculates the per fund limit, as it relates to investments by employees of the banking entity. Specifically, the Proposal would modify Sections __.12(c) and __.12(d) to require attribution of amounts paid by an employee or director to acquire a restricted profit interest only when the banking entity has financed the acquisition.

VI. Parallel Direct Investments

The Proposal would clarify that a banking entity need not include investments made alongside a covered fund in its per-fund and aggregate funds ownership limitations calculations as long as certain conditions are met. The clarification would be made in the form of a rule of construction which would provide that:

- A banking entity would not be required to include in the calculation of the investment limits under Section __.12(a)(2) any investment the banking entity makes alongside a covered fund as long as the investment was made in compliance with applicable laws and regulations, including applicable safety and soundness standards; and
- The amount of any investment the banking entity makes alongside a covered fund would not be restricted under Section __.12 as long as the investment was made in compliance with applicable laws and regulations, including applicable safety and soundness standards.

VII. Conclusion

Overall, the Proposal represents a meaningful step toward rationalizing the Volcker Rule. The proposed revisions include several changes that were requested by the structured finance industry as well as some other changes that likely will be welcomed by the banking entities subject to the Volcker Rule. However, there remain several areas in which the Proposal can be further refined. We expect that industry

comment letters will thoughtfully address these and other open items. The comment period on the Proposal will end on April 1, 2020.

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Endnotes

[1] *Agencies Propose Changes to Modify "Covered Funds" Restrictions of Volcker Rule* (January 30, 2020), available at https://www.occ.gov/news-issuances/news-releases/2020/nr-ia-2020-11.html.

[2] The 2019 revisions included incremental adjustments to limited aspects of the covered funds provisions, but deferred further action on other covered funds issues to a later rulemaking. *See* Mayer Brown's Legal Update on the 2019 Revisions: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/08/volcker-rule-2019-revisions-new.pdf.

[3] *See* Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 17, 2019), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190717a1.pdf; Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf.

[4] A loan securitization vehicle that relies on the exemption provided for in Rule 3a-7 under the Investment Company Act of 1940 would not need to rely on the LSE because it is not a covered fund.

[5] The Proposal does not address how off-balance sheet instruments (e.g., derivatives) would be valued under the 5 percent of total assets test.

[6] The Loan Securitization Servicing FAQ (#4) is available at https://www.federalreserve.gov/supervisionreg/faq.htm.

[7] The Loan Securitization Servicing FAQ defines "cash equivalents" as high quality, highly liquid investments whose maturity corresponds to the securitizations' expected or potential need for funds and whose currency corresponds to either the underlying loans or the asset-backed securities. The agencies are not requiring cash equivalents to be short term.

[8] For additional information on the FDIC and OCC proposed rulemaking, see Mayer Brown's Legal Update on the issue: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/01/betterforbanksproposedcommunityreinvestment.pdf.

[9] Proprietary trading means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments and includes purchasing or selling a financial instrument with a short-term trading intent. Section __.3(a)-(b).

[10] The Proposal notes that the proposed exclusion for credit funds is similar to the current exclusion for loan securitizations (other than the fact that the LSE requires the issuance of asset-backed securities, and the credit fund exclusion would prohibit it). Question 38 of the Proposal requests comments on potentially combining the two exclusions.

[11] The Proposal does not specify which safety and soundness standards the Agencies would consider applicable for the purposes of the credit fund exclusion. Question 33 of the Proposal suggests the Agencies are considering including references to banking agency safety and soundness regulations in the final rule and requests comments on what, if any, standards should be referenced in the exclusion.

[12] For example, a banking entity's investment in or relationship with a credit fund could be subject to the regulatory capital adjustments and deductions relating to investments in financial subsidiaries or in the capital of unconsolidated financial institutions, if applicable. See 12 C.F.R. § 217.22.

[13] The Proposal would define "family customer" as (i) a family client, as defined in Rule 202(a)(11)(G)-1(d)(4) of the Investment Advisers Act of 1940 (17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)) or (ii) any natural person who is a father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law or daughter-in-law of a family client, spouse or spousal equivalent of any of the foregoing.

[14] The Proposal would define "closely related person" as a natural person (including the state and estate planning vehicles of such person) who has longstanding business or personal relationships with any family customer.

[15] Such requirements include that an institution establish and maintain policies and procedures that are reasonably designed to manage credit exposure arising from the institution's intraday extensions of credit to affiliates. Additional guidance for compliance with this requirement can be found in Section 2020.1.8 of the Board's Bank Holding Company Supervision Manual, *available at* https://www.federalreserve.gov/publications/files/bhc.pdf.

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