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Legal Update

US Agencies Finalize Revisions to Volcker Rule Covered Funds Provisions

On June 25, 2020, the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), 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") finalized revisions to the covered funds provisions of the Volcker Rule (the "2020 Revisions").[1] The 2020 Revisions address the prohibitions and restrictions regarding covered fund activities. The Agencies intend for the 2020 Revisions 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 relating to certain transactions with affiliates 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;[2]
- 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.

The 2020 Revisions are largely consistent with the notice of proposed rulemaking published six months ago and incorporate comments received to questions posed in a 2018 proposal.[3] However, the 2020 Revisions also reflect some important, and welcome, clarifications and other adjustments.

In particular, non-US banks should appreciate the greater certainty under the codification of the exemptions for qualifying foreign excluded funds. Similarly, the structured finance industry should have a clearer and easier path to follow for its offerings, and issuers of structured products will have greater flexibility to design new and innovative products for their customers. All market participants should benefit from the adoption of exemptions from the Super 23A restrictions.

The 2020 Revisions become effective on October 1, 2020, and, unlike the Agencies' 2019 rulemaking focused on the proprietary trading provisions of the Volcker Rule, do not contain a transitional period or option for early adoption.[4]

We have summarized the finalized revisions below.

I. Exemptions for Qualifying Foreign Excluded Funds

The 2020 Revisions 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 become 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 would occur if a non-US banking entity controlled the excluded fund (e.g., based on common corporate governance, such as if 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 be subject to the Volcker Rule's proprietary trading and covered fund restrictions.

The federal banking agencies initially 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."[5] The 2020 Revisions codify this regulatory relief by creating an exemption for such funds using the same criteria as the policy statement. Specifically, the exemptions will 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 criteria: (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 or an affiliate of the foreign banking entity (other than the foreign excluded fund) to evade the requirements of the Volcker Rule.[6]

The 2020 Revisions also provide that foreign excluded funds are not required to maintain a Volcker Rule compliance program or comply with the reporting and documentation requirements of the Volcker Rule. However, a foreign excluded fund remains a banking entity under the Volcker Rule, and, therefore, transactions with a foreign excluded fund may be subject to the restrictions of Super 23A (discussed below).

II. Modifications to Existing Exclusions

A. LOAN SECURITIZATIONS[7]

The existing loan securitization exclusion ("LSE") excludes certain loan securitization vehicles[8] from the definition of covered funds if they hold only loans and certain loan-related rights and assets. The 2020 Revisions relax two key eligibility criteria to rely on the LSE.

First, the 2020 Revisions permit a qualifying loan securitization to hold debt securities (excluding asset-backed securities and convertible securities) of no more than 5 percent of the securitization's total assets.[9] This partially responds to industry feedback that historically such vehicles incorporated "bond buckets" and other types of non-loan assets in the pool of securitized loan assets. However, it is somewhat narrower than the proposal, which would have allowed holdings of any non-loan asset.[10]

Second, the 2020 Revisions codify an FAQ issued by 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.[11] The definition of "cash equivalents" in the FAQ relating to the definition of "permitted security" also is codified by the 2020 Revisions, clarifying that cash equivalents are not required to be short-term.[12] The preamble to the 2020 Revisions further states that the Agencies are not modifying or revoking any previously issued staff FAQs, unless otherwise specified.

In response to industry concern, the preamble to the 2020 Revisions explicitly clarifies that leases and leased property should be permissible assets under the LSE. Specifically, the preamble states that leases are already included in the definition of "loans," and thus are already permitted assets under the current exclusion, and notes that any residual value of such leased property upon expiration of an operating lease should meet the requirements to constitute an asset that is related or incidental to purchasing or otherwise acquiring and holding loans.

While not specifically addressed by the Agencies, the 2020 Revisions have the effect of relaxing the eligibility criteria for qualifying asset-backed commercial paper conduits and qualifying covered bonds. Those exclusions incorporate the LSE, and, therefore, vehicles that rely on those exclusions should be able to rely on the 5 percent bond bucket, expanded definition of cash equivalents, and clarified guidance on leases and leased assets.

B. FOREIGN PUBLIC FUNDS

The 2020 Revisions modify the current exclusion for foreign public funds by updating relevant definitions, requirements, and limitations.[13] 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 2020 Revisions 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 2020 Revisions modify the definition of "public offering" to add a new requirement that the distribution is subject to substantive disclosure and retail investor protection laws or regulations in the jurisdiction where it is made. Additionally, the 2020 Revisions limit the requirement that distributions comply with all applicable requirements in the jurisdiction where it is made to apply only 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 2020 Revisions also eliminate the limitation on selling ownership interests of the foreign public fund to US and non-US 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) remain in place.[14]

The 2020 Revisions clarify that attribution of ownership requirements in Section __.12(b) (which apply to certain registered investment companies, SEC-regulated business development companies, and foreign public funds), more clearly indicating that the ownership limit applies to the banking entity and its affiliates, in the aggregate, and the requirement that the banking entity provide advisory or other services can be satisfied by the banking entity or its affiliates.

C. PUBLIC WELFARE FUNDS AND SMALL BUSINESS INVESTMENT COMPANIES

1. Public Welfare Funds, Rural Business Investment Companies, and Qualified Opportunities Funds

The 2020 Revisions expand the exclusion for public welfare investment funds to explicitly incorporate funds, the business of which is to make investments that qualify for consideration under the federal banking agencies' regulations implementing the Community Reinvestment Act. They also add similar exclusions for rural business investment companies ("RBICs") and qualified opportunities funds (established under the "opportunity zone" program from the Tax Cuts and Jobs Act) ("QOFs").[15]

2. Small Business Investment Companies

The 2020 Revisions 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 specifies 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, will not be available for an SBIC that has had its license revoked.

III. New Covered Fund Exclusions

A. CREDIT FUNDS

The 2020 Revisions 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" is 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 (excluding commodity forward contracts and derivatives); and (iv) certain interest rate or foreign exchange derivatives.

The exclusion is subject to certain limitations and conditions. Under the 2020 Revisions, a credit fund may not (i) engage in activities that would constitute proprietary trading, as defined in Section __.3(b)(1)(i) of the Volcker Rule[16] (as if the fund were a banking entity), or (ii) issue asset-backed

securities.[17] Additionally, the availability of the credit fund exclusion is subject to compliance with the following conditions:

- If a banking entity sponsors or serves as an investment adviser or commodity trading advisor to a credit fund, the banking entity is 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 that are substantially similar to those that would apply if the banking entity engaged in the activities directly;
- A banking entity may not 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 under applicable federal banking law;
- A banking entity's investment in and relationship with a credit fund is required to comply with the "Super 23A" restrictions in Section __.14 (except the banking entity is 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 are required to comply with applicable safety and soundness standards; and
- A banking entity that invests in or has a relationship with a credit fund continues to be subject to capital charges and other requirements under applicable banking law.[18]

B. VENTURE CAPITAL FUNDS

The 2020 Revisions create a new exclusion for a qualifying "venture capital fund," which is defined as an issuer that meets the definition in Rule 203(l)-1 under the Investment Advisers 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.[19] 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 is 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 exclusion also requires a banking entity's ownership interest in or relationship with a qualifying venture capital fund 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. It also must 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 may not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the venture capital fund.

The preamble to the 2020 Revisions indicates that the Agencies determined not to impose a cap on the total annual revenue of an excluded venture capital fund. Additionally, other similar restrictions that were considered in the proposal, but generally were not supported by commenters, were not adopted.

C. FAMILY WEALTH MANAGEMENT VEHICLES

The 2020 Revisions create a new exclusion for family wealth management vehicles. Under the new exclusion, a "family wealth management vehicle" includes 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[20] and (ii) if the entity is not a trust, a majority of the voting interests and a majority of all interests are owned (directly or indirectly) by family customers and the entity is owned only by family customers and up to five closely related persons[21] of the family customers.[22]

Under the 2020 Revisions, this exclusion is 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;[23]
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 (or another third party) 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, although the banking entity may make such purchases from family wealth management vehicles if they are riskless principal transactions.

D. CUSTOMER FACILITATION VEHICLES

The 2020 Revisions create a new exclusion for customer facilitation vehicles. A customer facilitation vehicle will include any issuer formed by or at the request of a customer of a 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, including, for example, in connection with structured note issuances. Customers have considerable flexibility as there are no restrictions on the types of instruments which may be included within a customer facilitation vehicle.

While customer facilitation vehicles must be formed by or at the request of a customer, there is no reverse-inquiry requirement. A banking entity may discuss the potential structure of a customer facilitation vehicle and the related benefits, including legal, accounting and counterparty risk management advantages, with customers prior to the creation of any vehicle. Additionally, a banking entity may market its customer facilitation vehicle services.

A banking entity is 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;[24]
   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 (or another third-party) 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, although the banking entity may make such purchases from customer facilitation vehicles if they are riskless principal transactions.

3. 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 were not incorporated by the Volcker Rule. This resulted 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 2020 Revisions 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. However, the preamble to the 2020 Revisions clarifies that exemptions under Regulation W that require the related covered fund to be a securities affiliate generally would be available only if the related covered fund actually is a securities affiliate.

B. SHORT-TERM EXTENSIONS OF CREDIT AND ACQUISITIONS OF ASSETS IN CONNECTION WITH PAYMENT, CLEARING, AND SETTLEMENT SERVICES

The 2020 Revisions 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 include:

- Each short-term extension of credit or purchase of assets must 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 is required to be repaid, sold, or terminated no later than five business days after it was originated; and
- 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.[25]

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

C. RISKLESS PRINCIPAL TRANSACTIONS

The 2020 Revisions expand on the proposal by permitting a banking entity to engage in riskless principal transactions with a related covered fund. For these purposes, a riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset the contemporaneous sale to (or purchase from) the customer.

This standalone provision is modeled on the exemption in Regulation W, but is available even if the related covered fund is not a securities affiliate.

V. Narrowing of Definition of Ownership Interest

The Volcker Rule 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 included certain provisions that are standard creditor remedies in debt instruments of certain asset classes (e.g., the right to vote to remove an investment manager or to vote on a nominated replacement manager upon an investment manager's resignation or removal). To address this issue, as further described below, the Agencies (i) finalized clarifying amendments to the definition of "other similar interest" and (ii) created an express safe harbor for senior loans and senior debt. The Agencies also amended the manner in which banking entities must calculate their ownership interests for purposes of complying with the limits for certain exempted covered fund activities.

Additionally, in response to Question 79 from the proposal, the Agencies helpfully clarify that a debt interest in a covered fund would not be considered an ownership interest solely because the interest is entitled to receive an allocation of collections from the covered fund's underlying financial assets in accordance with a contractual priority of payments.

We anticipate that these adjustments to the definition of "ownership interest" will enable banking entities to invest in CLOs and other ABS loans and debt instruments without the need to rely on a specific covered fund exclusion. This should ease the compliance burden for banking entities that finance the securitization of loans.

A. CREDITOR REMEDIES

The 2020 Revisions expand on the proposal by more broadly revising the definition of ownership interest to provide clarity about the types of creditor rights that may attach to an interest without that interest being deemed an ownership interest. As was contemplated in the proposal, the 2020 Revisions modify the scope of the definition of ownership interest to allow for certain additional rights of creditors that are not triggered exclusively by an event of default or acceleration to attach to a debt interest without such interests being deemed ownership interests. Under the 2020 Revisions, the definition of ownership interest does not include rights of a creditor to participate in the removal or replacement of an investment manager for cause in connection with:

1. The bankruptcy, insolvency, conservatorship or receivership of the investment manager;
2. The breach by the investment manager of any material provision of the covered fund's transaction agreements applicable to the investment manager;
3. The breach by the investment manager of material representations or warranties;
4. The occurrence of an act that constitutes fraud or criminal activity in the performance of the investment manager's obligations under the covered fund's transaction agreements;
5. The indictment of the investment manager for a criminal offense or the indictment of any officer, member, partner or other principal of the investment manager for a criminal offense materially related to his or her investment management activities;
6. A change in control with respect to the investment manager;
7. The loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund's assets; or
8. Other similar events that constitute "cause" for removal of an investment manager, provided that such events are not solely related to the performance of the covered fund or to the investment manager's exercise of investment discretion under the covered fund's transaction agreements.

B. SAFE HARBOR

The 2020 Revisions 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) repayment of a fixed principal amount, on or before a maturity date, in a contractually determined manner;
- 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 2020 Revisions, but clarified that a senior loan or senior debt interest involves, among other things, repayment of a fixed principal amount, on or before a maturity date, in a contractually determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment). Our initial view is that, even without an explicit definition of "senior," the safe

harbor provides greater clarity around certain debt interests that structured finance industry participants ordinarily would not consider to be an ownership interest.

C. FUND INVESTMENT LIMITS

The 2020 Revisions 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 2020 Revisions 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 2020 Revisions 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 takes the form of a rule of construction which provides that:

- A banking entity is not 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 is not restricted under Section __.12 as long as the investment is made in compliance with applicable laws and regulations, including applicable safety and soundness standards.

VII. Conclusion

Overall, the 2020 Revisions represent a meaningful step toward rationalizing the Volcker Rule. The 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.

There remain several areas in which the Volcker Rule can be further refined, such as with respect to the treatment of long-term investment funds, which could be the subject of future rulemakings. Given the upcoming federal elections in the United States, such rulemakings are unlikely to commence before mid-2021, at the earliest.

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Endnotes

[1] Press Release, *Financial Regulators Modify Volcker Rule* (June 25, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625a.htm.

[2] The preamble to the 2020 Revisions indicate that the Agencies declined to adopt an exclusion for long-term investment funds. Some agency principals have left open the door to consider such an exclusion in the future. See Statement on Amendments to the Volcker Rule "Covered Fund" Provisions (June 25, 2020) ("we will continue to consider the treatment of long-term investment vehicles and remain open to hearing any additional suggestions for further improving the regulations implementing the Volcker Rule"), https://www.sec.gov/news/public-statement/peirce-roisman-volcker-rule-2020-06-25.

[3] 85 Fed. Reg. 12,120 (Feb. 28, 2020), https://www.federalregister.gov/documents/2020/02/28/2020-02707/prohibitions-and-restrictions-on-proprietary-trading-and-certain-interests-in-and-relationships-with; 83 Fed. Reg. 33432 (July 17, 2018), https://www.federalregister.gov/documents/2018/07/17/2018-13502/proposed-revisions-to-prohibitions-and-restrictions-on-proprietary-trading-and-certain-interests-in. The comment period on the 2020 proposal was informally extended until May 1, 2020 in light of the COVID-19 pandemic. Press Release, *Agencies Will Consider Comments on Volcker Rule Modifications Following Expiration of Comment Period* (Apr. 2, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200402a.htm.

[4] The 2019 revisions included incremental adjustments to limited aspects of the covered funds provisions, but deferred further action on other covered funds issues to the present 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.

[5] *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.

[6] The proposal would have extended the anti-evasion requirement to any banking entity. The 2020 Revisions limit the anti-evasion requirement to the foreign banking entity that sponsors or controls the foreign excluded fund and any affiliate thereof (except for the foreign excluded fund).

[7] See also Mayer Brown's blog post on the securitization-related changes in the 2020 Revisions: https://www.retainedinterest.com/2020/06/volcker-rule-revision-complete-easing-the-compliance-burden-for-banks/.

[8] A loan securitization vehicle that relies on the exemption provided 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.

[9] The value of debt securities is calculated at the most recent time of acquisition of such assets and generally with respect to the par value of the vehicle's loans, cash and cash equivalents, and debt securities at the time any such debt security is purchased (i.e., excluding the value of other rights or incidental assets, as well as derivatives held for risk management). In certain circumstances, fair market value may be used instead of par value.

[10] The 2020 Revisions retain the concept of impermissible assets, which include asset-backed securities and equity and debt securities (other than non-convertible debt securities up to the 5 percent limit and permitted securities), derivatives (other than interest rate and foreign exchange hedges), and commodity forward contracts.

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

[12] 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.

[13] The Agencies also addressed the seeding period discussed in FAQ #14 and clarified, depending on the facts and circumstances of a particular foreign public fund, the appropriate duration of its seeding period may vary and, under certain facts and circumstances, may exceed three years.

[14] The 2020 Revisions also codify that "predominantly" for foreign public funds means "more than 75 percent."

[15] The proposal questioned the treatment of RBICs and QOFs in relation to small business investment companies (discussed below). The preamble to the 2020 Revisions, however, discusses RBICs and QOFs in relation to the public welfare investment fund exclusion. SBICs and public welfare investment funds are addressed in the same section of the Volcker Rule.

[16] 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). The preamble to the 2020 Revisions notes that it may be possible for an excluded credit fund to engage in otherwise prohibited proprietary trading if it complies with the requirements of an exclusion or exemption from the prohibition against proprietary trading.

[17] The 2020 Revisions note 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).

[18] 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.

[19] The preamble to the 2020 Revisions notes that it may be possible for an excluded venture capital fund to engage in otherwise prohibited proprietary trading if it complies with the requirements of an exclusion or exemption from the prohibition against proprietary trading.

[20] The 2020 revisions 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.

[21] The 2020 Revisions 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.

[22] This is an incremental change from the proposal, which would have permitted only up to three closely related persons.

[23] The 2020 Revisions recognize that the banking entity may need to modify (i) disclosures to prevent the disclosure from being misleading and (ii) the manner of disclosure to accommodate the specific circumstances of the entity.

[24] As with family wealth management vehicles, the 2020 Revisions recognize that the banking entity may need to modify (i) disclosures to prevent the disclosure from being misleading and (ii) the manner of disclosure to accommodate the specific circumstances of the entity.

[25] 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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