

Legal Update

US Federal Banking Regulators Extend Expiring Interim Conditional Relief During Continuing Review of Regulation O

On December 22, 2020, the Board of Governors of the Federal Reserve System ("FRB" or "Board"), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation ("FDIC," collectively with the FRB and OCC, the "Agencies") issued their [Revised Statement Regarding Status of Certain Investment Funds and Their Portfolio Investments for Purposes of Regulation O and Reporting Requirements under Part 363 of FDIC Regulations](#) (Revised Statement), which supersedes and replaces their earlier [joint statement](#)¹ that was set to expire on January 1, 2021 (Original Statement). The relief provided under the Revised Statement will apply until January 1, 2022, unless amended, extended or superseded in writing prior to that time.

In the Revised Statement, the Agencies continue the interim conditional relief provided by the Original Statement and clarify the eligibility criteria for such relief.

The FRB, in consultation with the OCC and the FDIC, continues to actively consider whether to amend Regulation O to address the treatment of extensions of credit to fund complex-controlled portfolio companies under Regulation O.

In the interim, the Agencies believe it is appropriate to articulate supervisory expectations with respect to the application of Regulation O in this specific context in order to provide banks flexibility to lend to certain fund complex-controlled portfolio companies, subject to the following eligibility criteria²:

- 1) With regard to the fund complex:
 - a) The fund complex does not directly or indirectly control:
 - i. 15 percent or more of any class of voting securities of the bank³; or
 - ii. 20 percent or more of any class of voting securities of the bank if it has received applicable agency correspondence⁴ referencing at least such a percentage, if:
 1. No individual fund in the fund complex owns more than 10 percent of any class of voting securities of the bank. For this purpose, two or more funds that share the same or substantially the same investment objective and asset composition are treated as an individual fund; and

2. Non-index funds in the fund complex do not collectively own more than 10 percent of any class of voting securities of the bank.⁵
 - b) The fund complex does not have or seek to have any representative serve as an officer, agent, or employee of the bank; and
 - c) The fund complex does not exercise or attempt to exercise a controlling influence over the management or policies of the bank, including attempting to influence the dividend policies, loan, credit, or investment decisions or policies, pricing of services, personnel decisions, operations activities, or any other similar activities or decisions of the bank.
- 2) With regard to the bank, the bank does not knowingly make an extension of credit to a fund complex-controlled portfolio company, unless the terms of such extension of credit are on substantially the same terms as those prevailing for comparable transactions with unaffiliated third parties and do not involve more than normal risk of repayment or present other unfavorable features.

Conclusion

The Agencies have indicated that the application of Regulation O to fund complex-controlled portfolio companies is an unintended consequence. Therefore, the continuation of the relief in the Revised Statement may be viewed as a positive indication that the Agencies will amend Regulation O to permanently resolve the issue. However, Regulation O has not been comprehensively revised for many years, and the Agencies may intend to revisit the entire regulation through a single rulemaking. Accordingly, the industry should continue to identify areas for improvement and develop solutions for the eventual comment letters that will be requested.

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

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Endnotes

- ¹ Discussed in our December 30, 2019, Perspective "[US Federal Banking Regulators Consider Revision of Regulation O, Provide Interim Conditional Relief](#)."
- ² The relief under the Revised Statement does not cover a fund complex-controlled portfolio company that may be an insider of a bank for a reason other than its status as a related interest of a principal shareholder fund complex, such as by virtue of the portfolio company's status as a principal shareholder of the bank. In addition, this relief does not preclude a person from seeking rebuttal of the presumption of control pursuant to 12 CFR 215.2(c)(4).
- ³ For purposes of this Regulation O relief only, the Agencies will presume that a fund complex that (1) has provided passivity commitments to the Board in connection with a legal opinion issued by the Board's general counsel, (2) has provided a rebuttal of control to the OCC or (3) has entered into a passivity agreement with the FDIC—in each case, permitting the fund complex to directly or indirectly acquire up to 15 percent of the shares of a bank without making a filing under the Change in Bank Control Act, Bank Holding Company Act or Home Owners' Loan Act—meets the eligibility criteria with respect to its investment in the bank.
- ⁴ "Applicable agency correspondence" means that a fund complex (1) has provided passivity commitments to the FRB in connection with a legal opinion issued by the FRB's general counsel, (2) has provided a rebuttal of control to the OCC or (3) has entered into a passivity agreement with the FDIC—in each case permitting the fund complex to directly or indirectly acquire "up to 20 percent or more of the shares of a bank" without making a filing under the Bank Holding Company Act or Home Owners' Loan Act and with non-objection to a notice filed under the Change in Bank Control Act.
- ⁵ For purposes of this Regulation O relief only, an index fund is a fund that seeks to track the performance of a third-party reference index by buying and holding all or a representative sample of the securities in the index in approximately the same proportions as their representation in the index. A third-party reference index is an index not controlled by the principal shareholder fund complex.

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