

DEPARTMENT OF TREASURY
Office of the Comptroller of the Currency
12 CFR Part 44
Docket No. OCC-2020-0002
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FEDERAL RESERVE SYSTEM
12 CFR Part 248
Docket No. []
RIN []

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 351
RIN []

COMMODITY FUTURES TRADING COMMISSION
17 CFR Part 75
RIN []

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 255
Release no. []; File no. []
RIN []

Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

AGENCY: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Securities and Exchange Commission (SEC); and Commodity Futures Trading Commission (CFTC).

ACTION: Notice of proposed rulemaking.

SUMMARY: The OCC, Board, FDIC, SEC, and CFTC (together, the agencies) are inviting comment on a proposal that would amend the regulations implementing section 13 of the Bank Holding Company Act (BHC Act). Section 13 contains certain restrictions on the ability of a banking entity or nonbank financial company supervised by the Board to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund. The proposed amendments are intended to continue the agencies' efforts to improve and

streamline the regulations implementing section 13 of the BHC Act by modifying and clarifying requirements related to the covered fund provisions.

DATES: Comments must be received on or before April 1, 2020.

ADDRESSES: Interested parties are encouraged to submit written comments jointly to all of the agencies. Commenters are encouraged to use the title “**Proposed Revisions to Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds**” to facilitate the organization and distribution of comments among the agencies. Commenters are also encouraged to identify the number of the specific question for comment to which they are responding. Comments should be directed to:

OCC: You may submit comments to the OCC by any of the methods set forth below.

Commenters are encouraged to submit comments through the Federal eRulemaking Portal or e-mail, if possible. Please use the title “**Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds**” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

Federal eRulemaking Portal—“Regulations.gov Classic or Regulations.gov Beta”:

Regulations.gov Classic: Go to <https://www.regulations.gov/>. Enter “Docket ID OCC-2020-0002” in the Search Box and click “Search.” Click on “Comment Now” to submit public comments. For help with submitting effective comments please click on “View Commenter’s Checklist.” Click on the “Help” tab on the *Regulations.gov* home page to get information on using *Regulations.gov*, including instructions for submitting public comments.

Regulations.gov Beta: Go to <https://beta.regulations.gov/> or click “Visit New *Regulations.gov Site*” from the *Regulations.gov* Classic homepage. Enter “Docket ID OCC-2020-0002” in the

Search Box and click “Search.” Public comments can be submitted via the “Comment” box below the displayed document information or by clicking on the document title and then clicking the “Comment” box on the top-left side of the screen. For help with submitting effective comments please click on “Commenter’s Checklist.” For assistance with the *Regulations.gov* Beta site, please call (877) 378-5457 (toll free) or (703) 454-9859 Monday-Friday, 9am-5pm ET or e-mail *regulations@erulemakinghelpdesk.com*.

- **E-mail:** *regs.comments@occ.treas.gov*.
- **Mail:** Chief Counsel’s Office, Office of the Comptroller of the Currency, 400 7th Street, SW, suite 3E-218, Washington, DC 20219.
- **Hand Delivery/Courier:** 400 7th Street, SW., suite 3E-218, Washington, DC 20219.
- **Fax:** (571) 465-4326.

Instructions: You must include “OCC” as the agency name and “Docket ID OCC-2020-0002” in your comment. In general, the OCC will enter all comments received into the docket and publish the comments on the *Regulations.gov* website without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this rulemaking action by any of the following methods:

- **Viewing Comments Electronically** – Regulations.gov Classic or Regulations.gov

Beta:

Regulations.gov Classic: Go to <https://www.regulations.gov/>. Enter “Docket ID OCC-2020-0002” in the Search box and click “Search.” Click on “Open Docket Folder” on the right side of the screen. Comments and supporting materials can be viewed and filtered by clicking on “View all documents and comments in this docket” and then using the filtering tools on the left side of the screen. Click on the “Help” tab on the *Regulations.gov* home page to get information on using *Regulations.gov*. The docket may be viewed after the close of the comment period in the same manner as during the comment period.

Regulations.gov Beta: Go to <https://beta.regulations.gov/> or click “Visit New *Regulations.gov Site*” from the *Regulations.gov* Classic homepage. Enter “Docket ID OCC-2020-0002” in the Search Box and click “Search.” Click on the “Comments” tab. Comments can be viewed and filtered by clicking on the “Sort By” drop-down on the right side of the screen or the “Refine Results” options on the left side of the screen. Supporting materials can be viewed by clicking on the “Documents” tab and filtered by clicking on the “Sort By” drop-down on the right side of the screen or the “Refine Results” options on the left side of the screen. For assistance with the *Regulations.gov* Beta site, please call (877) 378-5457 (toll free) or (703) 454-9859 Monday-Friday, 9am-5pm ET or e-mail regulations@erulemakinghelpdesk.com.

The docket may be viewed after the close of the comment period in the same manner as during the comment period.

- **Viewing Comments Personally:** You may personally inspect comments at the OCC, 400 7th Street, SW, Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700 or, for persons who are deaf or hearing impaired, TTY, (202) 649-5597. Upon

arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect comments.

Board: You may submit comments, identified by [Docket No. ; RIN], by any of the following methods:

- **Agency website:** <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- **E-mail:** regs.comments@federalreserve.gov. Include docket and RIN numbers in the subject line of the message.
- **FAX:** (202) 452-3819 or (202) 452-3102.
- **Mail:** Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments will be made available on the Board's web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm> as submitted, unless modified for technical reasons or to remove personally identifiable information at the commenter's request. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room 146, 1709 New York Avenue NW, Washington, DC 20006, between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments, identified by [RIN] by any of the following methods:

- **Agency website:** <https://www.FDIC.gov/regulations/laws/federal/propose.html>. Follow instructions for submitting comments on the Agency website.
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

- **Hand Delivered/Courier:** Comments may be hand-delivered to the guard station at the rear of the 550 17th Street, NW, building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.
- **E-mail:** comments@FDIC.gov. Include the [RIN] on the subject line of the message.
- **Public Inspection:** All comments received must include the agency name and [RIN] for this rulemaking. All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/>, including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226 or by telephone at (877) 275-3342 or (703) 562-2200.

SEC: You may submit comments by the following methods:

Electronic Comments

- Use the SEC's internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or Send an e-mail to rule-comments@sec.gov. Please include [File Number xx-xx-xx] on the subject line.

Paper Comments

- Send paper comments in triplicate to Vanessa Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to [File Number []]. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The SEC will post all comments on the SEC's website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for website viewing and printing in the SEC's Public Reference Room, 100 F Street NE, Washington, DC 20549, on

official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that the SEC does not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the SEC or SEC staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any materials will be made available on the SEC's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at *www.sec.gov* to receive notifications by email.

CFTC: You may submit comments, identified by [RIN] and "Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," by any of the following methods:

- **Agency website:** <https://comments.cftc.gov>. Follow the instructions on the Web site for submitting comments.
- **Mail:** Send to Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, 1155 21st Street, NW, Washington, DC 20581.
- **Hand delivery/Courier:** Same as Mail above.

Please submit your comments using only one method. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to www.cftc.gov and the information you submit will be publicly available. If, however, you submit information that ordinarily is exempt from disclosure under the Freedom of Information Act, you may submit a petition for confidential treatment of the exempt information according to the procedures set forth in CFTC Regulation 145.9.1. The CFTC reserves the right,

but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from www.cftc.gov that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT:

OCC: Roman Goldstein, Risk Specialist, Treasury and Market Risk Policy, (202) 649-6360; Tabitha Edgens, Counsel; Mark O’Horo, Senior Attorney, Chief Counsel’s Office, (202) 649-5490; for persons who are deaf or hearing impaired, TTY, (202) 649-5597, Office of the Comptroller of the Currency, 400 7th Street, SW, Washington, DC 20219.

Board: Flora Ahn, Special Counsel, (202) 452-2317, Gregory Frischmann, Senior Counsel, (202) 452-2803, Kirin Walsh, Attorney, (202) 452-3058, or Sarah Podrygula, Attorney, (202) 912-4658, Legal Division, Elizabeth MacDonald, Manager, (202) 475-6316, Cecily Boggs, Senior Financial Institution Policy Analyst, (202) 530-6209, Jinai Holmes, Lead Financial Institution Policy Analyst, (202) 452-2834, Division of Supervision and Regulation; Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551.

FDIC: Bobby R. Bean, Associate Director, bbean@fdic.gov, Andrew D. Carayiannis, Senior Policy Analyst, acarayiannis@fdic.gov, or Brian Cox, Senior Policy Analyst, brcox@fdic.gov, Capital Markets Branch, (202) 898-6888; Michael B. Phillips, Counsel, mphillips@fdic.gov, or Benjamin J. Klein, Counsel, bklein@fdic.gov, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

SEC: Matthew Cook, Senior Counsel, Benjamin Tecmire, Senior Counsel, and Jennifer Songer, Branch Chief at (202) 551-6787 or IARules@sec.gov, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

CFTC: Cantrell Dumas, Special Counsel, (202) 418-5043, cdumas@cftc.gov; Jeffrey Hasterok, Data and Risk Analyst, (646) 746-9736, jhasterok@cftc.gov, Division of Swap Dealer and Intermediary Oversight; Mark Fajfar, Assistant General Counsel, (202) 418-6636, mfajfar@cftc.gov, Office of the General Counsel; Stephen Kane, Research Economist, (202) 418-5911, skane@cftc.gov, Office of the Chief Economist; Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

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I. Background

Section 13 of the Bank Holding Company Act of 1956 (BHC Act),¹ also known as the Volcker Rule, generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (covered fund).² The statute expressly exempts from these prohibitions various activities, including among other things:

- Underwriting and market making-related activities;
- Risk-mitigating hedging activities;
- Activities on behalf of customers;
- Activities for the general account of insurance companies; and
- Trading and covered fund activities and investments by non-U.S. banking entities solely outside the United States.³

In addition, section 13 of the BHC Act contains an exemption that permits banking entities to organize and offer, including sponsor, covered funds, subject to certain restrictions, including that banking entities do not rescue investors in those funds from loss, and are not

¹ 12 U.S.C. 1851.

² *Id.*

³ 12 U.S.C. 1851(d)(1).

themselves exposed to significant losses due to investments in or other relationships with these funds.⁴

Authority under section 13 of the BHC Act for developing and adopting regulations to implement the prohibitions, restrictions, and exemptions of section 13 is shared among the Board, the FDIC, the OCC, the SEC, and the CFTC (individually, an agency, and collectively, the agencies).⁵ The agencies originally issued a final rule implementing section 13 in December 2013 (the 2013 rule), and those provisions became effective on April 1, 2014.⁶

The agencies published a notice of proposed rulemaking in July 2018 (the 2018 proposed rule or 2018 proposal) that proposed several amendments to the 2013 rule.⁷ These proposed revisions sought to provide greater clarity and certainty about what activities are prohibited under the 2013 rule – in particular, under the prohibition on proprietary trading – and to better tailor the compliance requirements based on the risk of a banking entity’s activities. The

⁴ 12 U.S.C. 1851(d)(1)(G). Other restrictions and requirements include: (1) the banking entity provides bona fide trust, fiduciary, or investment advisory services; (2) the fund is organized and offered only to customers in connection with the provision of such services; (3) the banking entity does not have an ownership interest in the fund, except for a de minimis investment; (4) the banking entity complies with certain marketing restrictions related to the fund; (5) no director or employee of the banking entity has an ownership interest in the fund, with certain exceptions; and (6) the banking entity discloses to investors that it does not guarantee the performance of the fund. *Id.*

⁵ 12 U.S.C. 1851(b)(2).

⁶ Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule, 79 FR 5535 (Jan. 31, 2014).

⁷ Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 FR 33432 (July 17, 2018).

agencies issued a final rule implementing the amendments in November 2019 (the 2019 amendments), and those provisions became effective in January 2020.⁸

As part of the 2018 proposal, the agencies suggested targeted changes to the provisions of the 2013 rule relating to acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a fund and sought comments on other aspects of the covered fund provisions beyond those changes for which specific rule text was proposed.⁹ The 2019 amendments finalized those changes to the covered fund provisions for which specific rule text was proposed in the 2018 proposal. The agencies indicated they would continue to consider other aspects of the covered fund provisions and intended to issue a separate proposed rulemaking that specifically addresses those areas.¹⁰

The staffs of the agencies also have addressed several questions concerning the regulations implementing section 13 through a series of staff Frequently Asked Questions (FAQs).¹¹ In the 2018 proposal, the agencies requested comment on the effectiveness of the guidance provided in certain of these FAQs.¹² The agencies discussed comments received in the

⁸ Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 84 FR 61974 (Nov. 14, 2019). The agencies refer to the regulations implementing section 13 of the BHC Act that are effective as of **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]** as the “implementing regulations.”

⁹ 83 FR 33471–87.

¹⁰ 84 FR 62016.

¹¹ See <https://www.occ.treas.gov/topics/capitalmarkets/financial-markets/trading-volckerrule/volcker-rule-implementation-faqs.html> (OCC); <https://www.federalreserve.gov/bankinfo/reg/volcker-rule/faq.htm> (Board); <https://www.fdic.gov/regulations/reform/volcker/faq.html> (FDIC); <https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm> (SEC); https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_28_VolckerRule/index.htm (CFTC).

¹² 83 FR 33444–33446.

preamble to the 2019 amendments.¹³ The proposed rule would not modify or revoke any previously issued staff FAQs, unless otherwise specified.

*High-level Summary of Comments on 2018 Proposal*¹⁴

The agencies invited comment on all aspects of the 2018 proposal and received over 75 unique comments and approximately 3,700 comments from individuals using a version of a short form letter to express opposition to the 2018 proposed rule.¹⁵ The preamble to the 2019 amendments reviewed comments relating to the proprietary trading provisions of the 2018 proposal and the covered fund provisions that were adopted as part of the 2019 amendments. The agencies generally deferred public consideration of comments received on other aspects of the covered fund provisions to a future proposed rulemaking.

Various industry groups suggested maintaining the 2013 rule's base definition of covered fund, citing costs associated with complying with a new definition, while others supported an alternative definition. A number of industry groups and banks, and several Members of Congress, urged the agencies to amend the definition of covered fund to exclude certain funds, including the following: (1) family wealth investment vehicles; (2) funds that extend credit to customers; (3) long-term investment funds that do not engage in any short-term proprietary trading; (4) venture capital funds; and (5) customer facilitation funds. Various public interest commenters objected to any additional exclusions, citing insufficient notice in the 2018 proposal and the potential for evasion of the 2013 rule.

¹³ 84 FR 61978–61980.

¹⁴ This summary is not meant to be a comprehensive assessment of the comments received on the 2018 proposal and only reviews certain major areas of interest. Comments are discussed in greater detail throughout this Supplementary Information.

¹⁵ 84 FR 61976.

Commenters also proposed modifying the 2013 rule's existing exclusions from the definition of covered fund. Numerous industry groups suggested revising the exclusion for foreign public funds to focus on the characteristics of the fund and foreign regulations, rather than imposing specific conduct requirements that are difficult to monitor and verify. Several industry groups made various suggestions for simplifying the loan securitization exemption, including expanding the securities an issuer is permitted to hold and permitting an issuer to hold up to a certain percent of assets in non-loan assets.

Finally, several bank and industry group commenters supported making the exemptions under section 23A of the Federal Reserve Act and the Board's Regulation W available under section 13(f) of the BHC Act. Several such commenters also supported exempting certain payment, clearing, and settlement services from the restrictions. A foreign bank industry group also recommended limiting the application of section 13(f) to the U.S. operations of foreign firms.

II. Overview of Proposal

The agencies are issuing a notice of proposed rulemaking that proposes specific changes to the restrictions on covered fund investments and activities and other issues related to the treatment of investment funds in the implementing regulations (the proposal or the proposed rule). The proposed rule is intended to improve and streamline the covered fund provisions and provide clarity to banking entities so that they can offer financial services and engage in other permissible activities in a manner that is consistent with the requirements of section 13 of the BHC Act.

To better limit the extraterritorial impact of the implementing regulations, the proposal would exempt the activities of certain funds that are organized outside of the United States and

offered to foreign investors (qualifying foreign excluded funds) from the restrictions of the implementing regulations. In certain circumstances, some foreign funds that are not “covered funds” may be subject to the implementing regulations as “banking entities,” if they are controlled by a foreign banking entity, and thus could be subject to more onerous compliance obligations than are imposed on similarly-situated covered funds, even though the foreign funds have limited nexus to the United States. This provision would codify an existing policy statement by the Federal banking agencies that addresses the potential attribution to a foreign banking entity of the activities and investments of qualifying foreign excluded funds.

The proposal also would make modifications to several existing exclusions from the covered fund provisions, to provide clarity and simplify compliance with the requirements of the implementing regulations. First, the proposal would revise certain restrictions in the foreign public funds exclusion to more closely align the provision with the exclusion for similarly-situated U.S. registered investment companies. Second, the proposed rule would permit loan securitizations excluded from the rule to hold a small amount of non-loan assets, consistent with past industry practice, and codify existing staff-level guidance regarding this exclusion. In addition, the proposed rule would revise the exclusion for small business investment companies to account for the life cycle of those companies and would request comment on whether to clarify the scope of the exclusion for public welfare investments, including as it relates to rural business investment companies and qualified opportunity zone funds. Finally, the proposed rule would address concerns about certain components of the preamble to the 2013 rule related to calculating a banking entity’s ownership interests in covered funds.

The agencies recognized in the preamble to the 2013 rule that the definition of “covered fund” was expansive¹⁶ and, based on their experience implementing the rule, the agencies are now proposing several new exclusions from the covered fund provisions to address the potential over-breadth of the covered fund definition and related requirements. For example, the agencies recognize that the exclusions in the implementing regulations have inhibited banking entities’ relationships with credit funds, and the proposed rule would create a new exclusion for such funds. Under the proposal, banking entities would be able to invest in and have certain relationships with credit funds that extend the type of credit that a banking entity may provide directly, subject to certain safeguards. Relatedly, the proposed rule would establish an exclusion from the definition of covered fund for venture capital funds. This provision would help ensure that banking entities can fully engage in this important type of development and investment activity, which may facilitate capital formation and provide important financing for small businesses, particularly in areas where such financing may not be readily available.

The proposal also would include two new exclusions that would allow banking entities to provide certain traditional financial services via a fund structure, subject to certain safeguards. First, the proposed rule would exclude from the definition of covered fund an entity created and used to facilitate a customer’s exposures to a transaction, investment strategy, or other service. Second, the proposal would exclude from the covered fund definition wealth management vehicles that manage the investment portfolio of a family, and certain other persons, allowing a banking entity to provide integrated private wealth management services.

In addition, the proposed rule would permit a banking entity to engage in a limited set of covered transactions with a covered fund the banking entity sponsors or advises or with which

¹⁶ See 79 FR 5677.

the banking entity has certain other relationships. The implementing regulations generally prohibit all covered transactions between a covered fund and its banking entity sponsor or investment adviser. The agencies recognize that the existing restrictions have prevented banking entities from providing certain traditional banking services to covered funds, such as standard payment, clearing, and settlement services to related covered funds.

Lastly, the proposal would clarify certain aspects of the definition of ownership interest. Currently, due to the broad definition of ownership interest, some loans by banking entities to covered funds could be deemed to be ownership interests. The proposal would provide a safe harbor for bona fide senior loans or senior debt instruments to make clear that an “ownership interest” in a fund does not include such credit interests in the fund. In addition, the proposal would provide clarity about the types of credit rights that would be considered within the scope of the definition of ownership interest. Finally, the proposed rule would simplify compliance efforts by tailoring the calculation of a banking entity’s compliance with the implementing regulations’ aggregate fund limit and covered fund deduction, and provide clarity to banking entities regarding their permissible investments made alongside covered funds.¹⁷

The agencies request comment regarding all aspects of the proposed rule. Specific requests for comment are included in the following sections. Comments on the proposal must be submitted to the agencies on or before April 1, 2020.

¹⁷ Separately, the agencies are proposing various technical edits to the implementing regulations. See *infra* III.F (Technical Amendments).

III. Discussion of the Proposal

A. Qualifying Foreign Excluded Funds

Since the adoption of the 2013 rule, a number of foreign banking entities, foreign government officials, and other market participants have expressed concern regarding instances in which certain funds offered and sold outside of the United States are excluded from the covered fund definition but still could be considered banking entities in certain circumstances (foreign excluded funds).¹⁸ This situation may occur if a foreign banking entity controls the foreign fund. A foreign banking entity could be considered to control the fund based on common corporate governance structures abroad such as where the fund's sponsor selects the majority of the fund's directors or trustees, or otherwise controls the fund for purposes of section 13 of the BHC Act by contract or through a controlled corporate director. As a result, such a fund would be subject to the requirements of section 13 and the implementing regulations, including restrictions on proprietary trading, restrictions on investing in or sponsoring covered funds, and compliance obligations.

The Federal banking agencies released a policy statement on July 21, 2017 (the 2017 policy statement) to address concerns about the possible unintended consequences and extraterritorial impact of section 13 and the 2013 rule for foreign excluded funds.¹⁹ The 2017 policy statement noted that the staffs of the agencies were considering alternative ways in which

¹⁸ The 2013 rule generally excludes covered funds from the definition of "banking entity." 2013 rule § __.2(c)(2)(i). However, because foreign excluded funds are not covered funds, they can become banking entities through affiliation with other banking entities.

¹⁹ Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf>.

the 2013 rule could be amended, or other appropriate action could be taken, to address any unintended consequences of section 13 and the 2013 rule for foreign excluded funds.

For purposes of the 2017 policy statement, a “qualifying foreign excluded fund” meant, with respect to a foreign banking entity, an entity that:

- (1) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;
- (2) Would be a covered fund were the entity 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;
- (3) Would not otherwise be a banking entity except by virtue of the foreign banking entity’s acquisition or retention of an ownership interest in, or sponsorship of, the entity;
- (4) Is established and operated as part of a bona fide asset management business; and
- (5) Is not operated in a manner that enables the foreign banking entity to evade the requirements of section 13 or implementing regulations.

To provide additional time to consider this issue, the 2017 policy statement provided that the Federal banking agencies would not propose to take action during the one-year period ending July 21, 2018, against a foreign banking entity²⁰ based on attribution of the activities and investments of a qualifying foreign excluded fund to a foreign banking entity, or against a qualifying foreign excluded fund as a banking entity. To be eligible for this relief, the foreign banking entity’s acquisition or retention of any ownership interest in, or sponsorship of, the

²⁰ “Foreign banking entity” was defined for purposes of the 2017 policy statement to mean a banking entity that is not, and is not controlled directly or indirectly by, a banking entity that is located in or organized under the laws of the United States or any State.

qualifying foreign excluded fund must have met the requirements for permitted covered fund activities and investments solely outside the United States, as provided in section 13(d)(1)(I) of the BHC Act and § __.13(b) of the 2013 rule, as if the qualifying foreign excluded fund were a covered fund. The agencies extended this relief for an additional period of one year (until July 21, 2019) in the 2018 proposal.²¹ On July 17, 2019, the Federal banking agencies released a policy statement (the 2019 policy statement) that further extended this period to July 21, 2021.²² This additional time facilitates the agencies proposing the specific changes in the proposal to address this issue and will allow the public to submit comments in response to the proposal.²³

In response to questions in the 2018 proposal, several commenters urged the agencies to exclude controlled foreign funds offered solely outside the United States.²⁴ Many suggested that the agencies accomplish this by excluding these funds from the definition of banking entity.²⁵ Some commenters provided alternative proposals, including establishing a rebuttable presumption of compliance and making permanent the relief provided in the 2017 policy

²¹ 83 FR 33444.

²² Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 17, 2019), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190717a1.pdf>.

²³ The agencies did not propose any specific amendments to the 2013 rule in the 2018 proposal on this issue and instead requested comment on foreign excluded funds, the policy statements, and related issues. *See, e.g.*, 83 FR 33442-46.

²⁴ *See, e.g.*, Institute of International Bankers (IIB); American Investment Council (AIC); American Bankers Association (ABA); Financial Services Agency/Bank of Japan (FSA/BOJ); Canadian Bankers Association (CBA); Federated Investors (FI); BVI; European Banking Federation (EBF); Japanese Bankers Association (JBA); and Credit Suisse (CS).

²⁵ *Id.*

statement.²⁶ Several commenters suggested permitting foreign banking entities to opt to be treated as a covered fund, instead of a banking entity, and providing additional relief from the limitations on relationships with a covered fund, under section __.14.²⁷ One commenter suggested exempting from the definition of “banking entity” foreign excluded funds controlled by a non-U.S. banking entity as part of the non-U.S. banking entity’s asset management activities or in connection with consumer derivative activities not marketed to U.S. residents.²⁸ One commenter opposed any type of exclusion for foreign excluded funds and argued that the 2013 rule as it stands is adequate in relation to the nexus between U.S. and foreign activities.²⁹

To provide greater clarity and certainty to banking entities and qualifying foreign excluded funds, the agencies are proposing, pursuant to their authority under section 13(d)(1)(J) of the BHC Act, to exempt the activities of qualifying foreign excluded funds. Specifically, the agencies are proposing to exempt from the proprietary trading prohibition and covered fund restrictions the purchase or sale of a financial instrument by a qualifying foreign excluded fund and the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a qualifying foreign excluded fund, if any acquisition or retention of an ownership interest in, or sponsorship of, the qualifying foreign excluded fund by the foreign banking entity meets the requirements for permitted covered fund activities and investments solely outside the United States, as provided in section __.13(b) of the rule. Under the proposal, a qualifying foreign excluded fund has the same meaning as in the 2017 and 2019 policy statements as described above.

²⁶ *See, e.g.*, EBF and IIB.

²⁷ *See, e.g.*, EBF; CS; IIB; and CBA.

²⁸ BVI.

²⁹ Data Boiler.

Section 13(d)(1)(H) and (I) of the BHC Act permit foreign banking entities to conduct certain trading and investing activities outside the United States, notwithstanding the restrictions under section 13(a) of the BHC Act. As indicated in the preamble to the 2013 rule, the purpose of these statutory provisions is to limit the extraterritorial application of section 13 as it applies to foreign banking entities.³⁰

In addition, section 13(d)(1)(J) of the BHC Act gives the agencies rulemaking authority to exempt activities from the prohibitions of section 13, provided the agencies determine that the activity in question would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.³¹ The agencies believe that the proposal described above would be consistent with the purposes of section 13(d)(1)(H) and (I) of the BHC Act and could promote and protect the safety and soundness of banking entities and U.S. financial stability.

Exempting the activities of qualifying foreign excluded funds in the circumstances described above would provide clarity and certainty to, and likely promote and protect the safety and soundness of, such banking entities. This relief would be limited to the asset management activities of these foreign funds, which are organized outside of the United States and operate pursuant to the local laws of foreign jurisdictions. Thus, if the activities of these foreign funds were subjected to the restrictions applicable to banking entities, generally, their asset management activities may be significantly disrupted, and the foreign banking entities may be at

³⁰ 79 FR 5655 n. 1518 (identifying statement of Sen. Merkley regarding how section 13(d)(1)(H) “recognize[s] rules of international comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law”). The agencies believe that the same rationale applies to section 13(d)(1)(I).

³¹ 12 U.S.C. 1851(d)(1)(J).

a competitive disadvantage to other foreign bank and non-bank market participants conducting asset management business outside of the United States. Exempting the activities of these foreign funds would also allow their foreign banking entity sponsors to continue to conduct their asset management business outside the United States as long as the foreign banking entity's acquisition of an ownership interest in or sponsorship of the fund meets the requirements in section __.13(b). Thus, the proposed exemption may have the effect of promoting the safety and soundness of these foreign funds and their sponsors, while at the same time limiting the extraterritorial impact of the implementing regulations, consistent with the purposes of section 13(d)(1)(H) and (I) of the BHC Act.

The proposed exemption would also promote and protect U.S. financial stability. While qualifying foreign excluded funds have very limited nexus to the U.S. financial system, they are permitted to invest in U.S. companies. Therefore, to the extent that these funds have any direct impact on U.S. financial stability, it would be to promote U.S. financial stability by providing additional capital and liquidity to U.S. capital markets. Because the proposed exemption would require that the foreign banking entity's acquisition of an ownership interest in or sponsorship of the fund meets the requirements in section __.13(b), the exemption would ensure that the risks of the investments made by these foreign funds would be booked to foreign entities in foreign jurisdictions, thus promoting and protecting U.S. financial stability. Additionally, subjecting such funds to the requirements of section 13 of the BHC Act imposed on banking entities could precipitate disruptions in foreign capital markets, which could generate spillover effects in the U.S. financial system.

Question 1. Should the agencies make any other amendments to §§__.6 and __.13 or include any additional parameters on the proposed exemption? Why or why not?

Question 2. Would the proposed amendments to §§ __.6 and __.13 address the concerns raised regarding unintended consequences and extraterritorial impact? Why or why not? If the amendments would not address these concerns, what other amendments should be made?

Question 3. Is the proposed approach to addressing foreign excluded funds effective? Why or why not? If not, what alternative approach would better address these types of entities?

Question 4. Would the use of the term “covered fund” in § __.13(b)(1) or in proposed § __.13(d)(2), together with the definition of “covered fund” in § __.10(b)(1), create any unintended consequences for foreign banking entities seeking to rely on the exemption for activities permitted by section 13(d)(1)(I) of the BHC Act? Why or why not? If so, what other alternatives should be considered to make the exemption for activities permitted by section 13(d)(1)(I) of the BHC Act clear or more workable?

Question 5. What impacts would the proposed amendments to §§ __.6 and __.13 have on the safety and soundness of banking entities, and on the financial stability of the United States? Would the activities permitted under the proposed amendments to §§ __.6 and __.13 of the regulations promote and protect safety and soundness and U.S. financial stability? Please explain.

B. Modifications to Existing Covered Fund Exclusions

1. Foreign Public Funds

In addition to the foreign excluded fund issues discussed above with respect to the banking entity definition, there are other foreign fund issues that arise under the covered fund definition. In order to provide consistent treatment between U.S. registered investment companies and their foreign equivalents, the implementing regulations exclude foreign public funds from the definition of covered fund. A foreign public fund is generally defined under the

implementing regulations as any issuer that is organized or established outside of the United States and the ownership interests of which are (1) authorized to be offered and sold to retail investors in the issuer's home jurisdiction and (2) sold predominantly through one or more public offerings outside of the United States.³² The agencies stated in the preamble to the 2013 rule that they generally expect that an offering is made predominantly outside of the United States if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States.³³ The 2013 rule defines "public offering" for purposes of this exclusion to mean a "distribution," as defined in § __.4(a)(3) of subpart B, of securities in any jurisdiction outside the United States to investors, including retail investors, provided that the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.³⁴

³² See 2013 rule § __.10(c)(1); see also 79 FR 5678 ("For purposes of this exclusion, the [a]gencies note that the reference to retail investors, while not defined, should be construed to refer to members of the general public who do not possess the level of sophistication and investment experience typically found among institutional investors, professional investors or high net worth investors who may be permitted to invest in complex investments or private placements in various jurisdictions. Retail investors would therefore be expected to be entitled to the full protection of securities laws in the home jurisdiction of the fund, and the [a]gencies would expect a fund authorized to sell ownership interests to such retail investors to be of a type that is more similar to a U.S. registered investment company rather than to a U.S. covered fund.").

³³ 79 FR 5678.

³⁴ 2013 rule § __.10(c)(1)(iii).

The 2013 rule places an additional condition on a U.S. banking entity's ability to rely on the foreign public fund exclusion with respect to any foreign fund it sponsors.³⁵ The foreign public fund exclusion is only available to a U.S. banking entity with respect to a foreign fund sponsored by the U.S. banking entity if, in addition to the requirements discussed above, the fund's ownership interests are sold predominantly to persons other than the sponsoring banking entity, the issuer (or affiliates of the sponsoring banking entity or issuer), and employees and directors of such entities.³⁶ The agencies stated in the preamble to the 2013 rule that, consistent with the agencies' view concerning whether a foreign public fund has been sold predominantly outside of the United States, the agencies generally expect that a foreign public fund would satisfy this additional condition if 85 percent or more of the fund's interests are sold to persons other than the sponsoring U.S. banking entity and the specified persons connected to that banking entity.³⁷

In adopting the foreign public fund exclusion, the agencies' view was that it was appropriate to exclude these funds from the "covered fund" definition because they are sufficiently similar to U.S. registered investment companies.³⁸ The agencies also expressed the view that the additional condition applicable to U.S. banking entities with respect to foreign funds that they sponsor was designed to treat foreign public funds consistently with similar U.S.

³⁵ Although the discussion of this condition generally refers to U.S. banking entities for ease of reading, the condition also applies to foreign subsidiaries of a U.S. banking entity. *See* 2013 rule § __.10(c)(1)(ii) (applying this limitation "[w]ith respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor").

³⁶ *See* 2013 rule § __.10(c)(1)(ii).

³⁷ 79 FR 5678.

³⁸ *Id.*

funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States, while also seeking to limit the possibility for evasion through foreign public funds.³⁹

Based on experience implementing the 2013 rule, as well as discussions with and comments received from regulated entities, it appears that some of the conditions of the foreign public fund exclusion may not be necessary to ensure consistent treatment of foreign public funds and registered investment companies. Moreover, some conditions may make it difficult for a non-U.S. fund to qualify for the exclusion or for a banking entity to validate whether a non-U.S. fund qualifies for the exclusion, resulting in certain non-U.S. funds that are similar to U.S. registered investment companies being treated as covered funds. For example, the requirement that the fund be authorized to be offered and sold to retail investors in the fund's home jurisdiction (the home jurisdiction requirement) disqualifies certain funds that are organized in one jurisdiction but only authorized to be sold to retail investors in another jurisdiction.⁴⁰ It appears that, for a variety of reasons, it is not uncommon for foreign retail funds to be organized in one jurisdiction and sold in another jurisdiction.⁴¹

Additionally, the requirement that a fund be sold "predominantly" through one or more public offerings may cause certain compliance and monitoring difficulties.⁴² This is because banking entities may have limited visibility into the distribution history of a third-party

³⁹ *Id.*

⁴⁰ *See, e.g.,* IIB; Bank Policy Institute (BPI); EBF; and JBA.

⁴¹ For example, commenters have noted that retail funds are sometimes organized in the Cayman Islands for tax considerations but only offered for sale in Japan. *See, e.g.,* BPI.

⁴² *See, e.g.,* BPI.

sponsored fund, or, in the case of a fund sponsored by the banking entity, the fund’s interests may be sold through third-party distributors, and the precise pattern of distribution may be affected by market forces and changes in investor demand.⁴³ Also, the limitation on ownership of interests in a U.S. banking entity-sponsored foreign public fund by certain employees (including their immediate family members) of the sponsoring banking entity or fund may be difficult for banking entities to monitor for similar reasons, and imposes a requirement on foreign public funds that may not apply to similarly situated U.S. registered investment companies.⁴⁴ Finally, commenters have expressed concerns with the expectation stated in the preamble to the 2013 rule that for a U.S. banking entity-sponsored foreign fund to satisfy the condition that it be “predominantly” sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity, 85 percent of the ownership interests in the fund should be sold to such persons.⁴⁵

To address the concerns noted above related to the home jurisdiction requirement and the requirement that ownership interests be sold predominantly through public offerings, the agencies are proposing to replace those two requirements with a requirement that the fund is authorized to offer and sell ownership interests, and such interests are offered and sold, through one or more public offerings. The agencies are also proposing to modify the definition of “public offering” from the implementing regulations to add a new requirement that the distribution is subject to substantive disclosure and retail investor protection laws or regulations, to help ensure that funds qualifying for this exclusion are sufficiently similar to U.S. registered

⁴³ *Id.*

⁴⁴ *See, e.g.,* IIB.

⁴⁵ *See, e.g.,* Investment Company Institute.

investment companies. Additionally, the proposal would only apply the condition that the distribution comply with all applicable requirements in the jurisdiction where it is made to instances in which the banking entity acts as the investment manager, investment adviser, commodity trading advisor, commodity pool operator, or sponsor. This change is intended to address the potential difficulty that a banking entity investing in a third-party sponsored fund may have in determining whether the distribution of such fund complied with all the requirements in the jurisdiction where it was made.

The changes discussed above would seek to ensure that the exclusion remains limited to funds that are authorized to be sold to retail investors, but it would no longer require the fund to be authorized to be sold to retail investors in the jurisdiction where it is organized. Additionally, while the fund would still be required to be offered and sold through one or more public offerings (which would require, among other things, that the distribution be made in a jurisdiction outside the United States that subjects the foreign public fund to substantive disclosure and retail investor protection laws or regulations), the proposal would eliminate the requirement that it be sold “predominantly” through one or more public offerings. This change would eliminate the difficulty that banking entities have described in tracking the specific distribution patterns of ownership interests in such funds, and it would more closely align the treatment of foreign public funds with that of U.S. registered investment companies, which have no such requirement. The agencies believe the revised requirement would help ensure that the foreign public fund is sufficiently similar to a U.S. registered investment company.

To simplify the requirements of the exclusion and address concerns described by banking entities with the difficulty in tracking the sale of ownership interests to employees and their immediate family members, the proposal would eliminate the limitation on selling ownership

interests of the issuer to employees (other than senior executive officers) of the sponsoring banking entity or the issuer (or affiliates of the banking entity or issuer). This change would also help to align the treatment of foreign public funds with that of U.S. registered investment companies, as the exclusion for U.S. registered investment companies has no such limitation. The proposal would continue to limit the sale of ownership interests to directors or senior executive officers of the sponsoring banking entity or the fund (or their affiliates), as the agencies believe that such a requirement would be simpler for a banking entity to track. As discussed in the preamble to the 2013 rule, this requirement is intended to prevent evasion of section 13 of the BHC Act.⁴⁶

As reflected in the detailed questions that follow, the agencies request comment on all aspects of the proposed modifications to the foreign public fund exclusion, including whether the exclusion is effective in identifying foreign funds that may be sufficiently similar to U.S. registered investment companies and permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States, without creating opportunities for evasion of the requirements of section 13 of the BHC Act.

Question 6. Are foreign funds that satisfy the proposed conditions in the foreign public fund exclusion sufficiently similar to U.S. registered investment companies such that it is appropriate to exclude these funds from the covered fund definition? Why or why not? If these foreign funds are not sufficiently similar to U.S. registered investment companies, how should the agencies modify the exclusion's conditions to permit only funds that are sufficiently similar to U.S. registered investment companies to rely on it? Are there foreign funds that cannot satisfy the exclusion's proposed conditions but that are nonetheless sufficiently similar to U.S.

⁴⁶ 79 FR 5678–79.

registered investment companies such that it would be appropriate to exclude those foreign funds from the covered fund definition? If so, how should the agencies modify the exclusion's conditions to permit those funds to rely on it?

Question 7. How effectively does the proposed replacement of the home jurisdiction requirement and the requirement that ownership interests be sold predominantly through public offerings with a requirement that the fund is authorized to offer and sell ownership interests, and such interests are offered and sold, through one or more public offerings address the concerns discussed above related to the compliance with these requirements? If such concerns are not addressed, how should the agencies further modify these requirements?

Question 8. Is the additional condition added to the "public offering" definition requiring the distribution be subject to substantive disclosure and retail investor protection laws or regulations sufficiently clear and effective? If not, how should the agencies modify or clarify this requirement? Should the agencies further specify features of "substantive disclosure and retail investor protection laws or regulations?" Would it be clearer if the agencies identified particular types of laws or regulations that would meet this condition (e.g., requirements for periodic filings with, and periodic examinations by, the appropriate regulatory authority; requirements for periodic reports to be distributed to retail investors; or a prohibition against fraud)?

Question 9. In what ways, if any, is it difficult for a banking entity to determine whether a fund satisfies the implementing regulations' condition of the "public offering" definition requiring that the distribution comply with all applicable requirements in the jurisdiction in which the distribution is made? Should the agencies eliminate this requirement with respect to funds for which the banking entity does not serve as the investment manager, investment adviser, commodity trading advisor, commodity pool operator, or sponsor, as proposed, or should this

requirement be otherwise modified? Would eliminating or modifying this requirement create an opportunity for evasion of the requirements of section 13? If so, how should the agencies address this concern?

Question 10. As discussed above, the agencies propose to modify the additional conditions on U.S. banking entity-sponsored foreign funds, which are intended in part to limit the possibility for evasion of section 13. In what ways, if any, would the proposed modifications, including the elimination of the limitations on certain employees owning interests in the fund, create an opportunity for evasion? How should the agencies modify these additional requirements to limit the possibility for evasion? Is the limitation on directors and senior executive officers owning interests in the fund necessary or appropriate to prevent evasion of section 13? Why or why not? Should the agencies eliminate or modify this limitation? How difficult is it for banking entities to monitor and track this limitation? Commenters should address whether banking entities already track this information.

Question 11. Is the proposed requirement that the fund's ownership interests are sold predominantly to persons other than the sponsoring banking entity or the issuer (or affiliates of the sponsoring banking entity or issuer), and directors and senior executive officers of such entities, necessary to prevent evasion of the requirements of section 13? If the requirement is not necessary to prevent evasion, how should the agencies eliminate or further modify this requirement? Should the agencies consider this condition satisfied if 75 percent (or some other percentage) of the ownership interests are sold to persons other than the sponsoring banking entity, the issuer (or affiliates of the sponsoring banking entity or issuer), and directors and senior executive officers of such entities? Why or why not?

Question 12. Do the proposed changes to the foreign public fund exclusion, in the aggregate, increase opportunities for evasion of the requirements of section 13? If so, how should the agencies address these concerns? Should the agencies include a specific reservation of authority to prevent evasion through the foreign public fund exclusion, or are the anti-evasion provisions in § __.21 of the implementing regulations sufficient to address these concerns?⁴⁷

2. Loan Securitizations

Section 13 of the BHC Act provides that nothing in this section shall be construed to limit or restrict the ability of a banking entity... to sell or securitize loans in a manner otherwise permitted by law.⁴⁸ To effectuate this statutory requirement, the 2013 rule excludes from the definition of covered fund loan securitizations that issue asset-backed securities and hold only loans, certain rights and assets, and a small set of other financial instruments (permissible assets).⁴⁹ The staffs of the agencies in June 2014 issued an FAQ explaining that assets other than permitted securities can be servicing assets for purposes of the loan securitization exclusion.⁵⁰

⁴⁷ Section __.21 of the implementing regulations provides in part that whenever an agency finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or the implementing regulations, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or the implementing regulations, the agency may take any action permitted by law to enforce compliance with section 13 of the BHC Act and the 2013 rule, including directing the banking entity to restrict, limit, or terminate any or all activities under the 2013 rule and dispose of any investment.

⁴⁸ 12 U.S.C. 1851(g)(2).

⁴⁹ See 2013 rule § __.10(c)(8). Loan is further defined as any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative. Implementing regulations § __.2(t).

⁵⁰ Loan Securitization Servicing FAQ. See *supra* n. 11 and accompanying text. See also, *infra*, Leases and Servicing Assets for a discussion of the FAQ.

Since the adoption of the 2013 rule, several banking entities and other participants in the loan securitization industry have commented that the limited set of permissible assets has inappropriately restricted their ability to use the loan securitization exclusion. The agencies asked several questions regarding the efficacy and scope of the exclusion and the Loan Securitization Servicing FAQ in the 2018 proposal.⁵¹ Comments were focused on permitting small amounts of non-loan assets and clarifying the treatment of leases and related assets. The agencies are proposing to codify the Loan Securitization Servicing FAQ and permit loan securitizations to hold a small amount of non-loan assets. The agencies also request comment on whether other revisions are necessary or appropriate to effectuate section 13 of the BHC Act, as described in greater detail below.

Leases and Servicing Assets

The 2013 rule defines “loan” to include leases and permits loan securitizations to hold rights or other assets (servicing assets) that arise from the structure of the loan securitization or from the loans supporting a loan securitization.⁵² Rights or other servicing assets are assets designed to facilitate the servicing of the assets underlying a loan securitization or the distribution of proceeds from those assets to holders of the asset-backed securities.⁵³ In response to confusion regarding the scope of these two provisions, the staffs of the agencies released the Loan Securitization Servicing FAQ. Under this FAQ, a servicing asset may or may not be a security, but if the servicing asset is a security, it must be a permitted security under the rule.

⁵¹ 83 FR 33480–81.

⁵² 2013 rule §§ ____.2(s); ____.10(c)(8)(i)(D), (v).

⁵³ See, e.g., FASB Statement No. 156: Accounting for Servicing of Financial Assets, ¶ 61 (FAS 156).

Several commenters on the 2018 proposal supported codifying this FAQ, with one commenter encouraging the agencies to include specific examples of servicing assets.⁵⁴ However, one commenter suggested that the Loan Securitization Servicing FAQ was sufficient and that the regulation need not be modified.⁵⁵ Another commenter suggested that the exclusion be expanded to cover leases and related assets, including operating or capital leases.⁵⁶

The agencies propose codifying the Loan Securitization Servicing FAQ to clarify the scope of the servicing asset provision.⁵⁷ However, the agencies are not proposing to separately list leases within the loan securitization exclusion because leases are included in the definition of loan and thus are permitted assets for loan securitizations under the current exclusion.⁵⁸

Question 13. Does the proposed modification of the loan securitization exclusion sufficiently permit securitization of leases, servicing assets, and related assets, including leases that are security interests? Why or why not?

Limited Holdings of Non-Loan Assets

In the preamble to the 2013 rule, the agencies declined to permit loan securitizations to hold a certain amount of non-loan assets.⁵⁹ The agencies supported a narrow scope of permissible assets by noting that “the purpose underlying section 13 is not to expand the scope of

⁵⁴ Structured Finance Industry Group (SFIG) and JBA.

⁵⁵ Data Boiler.

⁵⁶ SFIG.

⁵⁷ The proposal also clarifies that special units of beneficial interest and collateral certificates meeting the requirements of paragraph (c)(8)(v) of the exclusion that are securities need not meet the requirements of paragraph (c)(8)(iii) of the exclusion.

⁵⁸ See implementing regulations § __.2(t).

⁵⁹ 79 FR 5687–88.

assets in an excluded loan securitization beyond loans as defined in the final rule and the other assets that the Agencies are specifically permitting in a loan securitization.”⁶⁰

Several commenters on the 2018 proposal disagreed with the agencies’ views and supported expanding the range of permissible assets in an excluded loan securitization.⁶¹ Many commenters recommended allowing loan securitizations to hold up to five or ten percent of non-loan assets. Commenters suggested that a limited bucket of non-loan assets would be consistent with exclusions under the Investment Company Act, such as section 3(c)(5)(C) and rule 3a-7.⁶² Commenters argued that banking entities would use such authority to incorporate into securitizations corporate bonds, interests in letters of credit, cash and short-term highly liquid investments, derivatives, and senior secured bonds that do not significantly change the nature and risk profile of the securitization.⁶³ One commenter suggested permitting additional non-loan assets so long as the securitization is “primarily backed by qualifying assets that are not impermissible securities or derivatives.”⁶⁴

One commenter suggested that permitting loan securitizations to hold a small number of non-loan assets, typically fixed income securities, would decrease compliance burdens associated with analyzing fund assets and increase fund managers’ flexibility in responding to market conditions and customer preferences.⁶⁵ One commenter also claimed that permitting non-loan

⁶⁰ 79 FR 5687.

⁶¹ *E.g.*, Investment Adviser Association (IAA); Loan Syndications and Trading Association (LSTA); ABA; SFIG; Goldman Sachs (GS); BPI; JBA; and Securities Industry and Financial Markets Association (SIFMA).

⁶² BPI.

⁶³ LSTA and JBA.

⁶⁴ SFIG.

⁶⁵ SFIG.

holdings below a certain threshold would conform the rule with industry practice without requiring a wholesale redefinition of covered funds.⁶⁶ In addition, some commenters maintained that such an approach was consistent with the rule of construction because inclusion of small amounts of non-permissible assets was standard practice, particularly for international securitizations, and permitted by law.⁶⁷ In contrast, another commenter objected to allowing a limited amount of non-loan investments and suggested that permitting such investments would be contrary to the general purpose of section 13 of the BHC Act, which the commenter claimed was to divest banking entities of risky assets.⁶⁸

After considering the comments received on the 2018 proposal, the agencies are proposing to allow a loan securitization vehicle to hold up to five percent of assets in non-loan assets. Authorizing loan securitizations to hold small amounts of non-loan assets could, consistent with section 13 of the BHC Act, permit loan securitizations to respond to market demand and reduce compliance costs associated with the securitization process without significantly increasing risk to banking entities and the financial system. The proposed limit on the amount of non-loan assets also would assuage potential concerns that allowing certain non-loan assets will lead to evasion, indirect proprietary trading, and other impermissible activities or excessive risk to the banking entity. Moreover, loan securitizations provide an important avenue for banking entities to fund lending programs, and allowing loan securitizations to hold a small

⁶⁶ LSTA.

⁶⁷ LSTA and SIFMA. Some of these commenters subsequently indicated that the loan securitization industry has evolved since the issuance of the 2013 rule and loan securitization issuers no longer include non-loan assets and might not include non-loan assets in a securitization even if the scope of non-loan assets permitted to be held was expanded.

⁶⁸ Data Boiler.

amount of non-loan assets in response to customer and market demand may increase a banking entity's capacity to provide financing and lending.

Question 14. Should the loan securitization exclusion permit loan securitization issuers to hold a certain percentage of non-loan assets? Why or why not? If so, should the maximum percentage of permissible non-loan assets be five or ten percent, or some other amount?

Regardless of the non-loan asset limit, what should be the method of calculating compliance with the limit (e.g., market value, par value, principal balance, or some other measure)? Would permitting loan securitization issuers to hold a certain percentage of non-loan assets further the statutory rule of construction in section 13(g)(2) of the BHC Act? If so, explain how.

Question 15. In what ways, if any, should the agencies limit the type of permissible non-loan assets to certain asset classes or structures (e.g., only debt securities or any permissible asset, such as a derivative)? Would the inclusion of certain financial instruments—such as derivatives and collateralized debt obligations—raise safety and soundness concerns? If so, should qualifying loan securitizations be permitted to hold such instruments and, if so, what restrictions should be placed on the holding of such instruments? What, if any, other restrictions should the agencies impose on non-loan assets to reduce the potential for evasion of the rule?

Cash Equivalents

The loan securitization exclusion permits issuers to hold certain types of contractual rights or assets directly arising from the loans supporting the asset-backed securities that a loan securitization relying on the exclusion may hold, including cash equivalents. In response to questions about the scope of the cash equivalent provision, the Loan Securitization Servicing FAQ stated that “cash equivalents” means high quality, highly liquid investments whose maturity corresponds to the securitization's expected or potential need for funds and whose

currency corresponds to either the underlying loans or the asset-backed securities.⁶⁹ To promote transparency and clarity, the proposal would codify this additional language in the Loan Securitization Servicing FAQ regarding the meaning of “cash equivalents.”⁷⁰ The agencies are not requiring “cash equivalents” to be “short term,” because the agencies recognize that a loan securitization may need greater flexibility to match the maturity of high quality, highly liquid investments to its expected or potential need for funds.

Question 16. Should the agencies codify the cash equivalents language in the Loan Securitization Servicing FAQ? Why or why not?

3. Public Welfare and Small Business Funds

i. Public Welfare Funds

Section 13(d)(1)(E) of the BHC Act permits, among other things, a banking entity to make and retain investments that are designed primarily to promote the public welfare of the type permitted under 12 U.S.C. 24(Eleventh).⁷¹ Consistent with the statute, the 2013 rule excludes from the definition of “covered fund” issuers that make investments that are designed primarily to promote the public welfare, of the type permitted under paragraph 11 of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24).⁷² The agencies noted in the preamble to the 2013 rule that excluding issuers in the business of making public welfare investments would give effect to the statutory exemption for these investments. The agencies further stated their belief that permitting a banking entity to sponsor and invest in entities that are

⁶⁹ *See supra*, n. 11.

⁷⁰ Proposed rule § __.10(c)(8)(iii)(A).

⁷¹ *See* 12 U.S.C. 1851(d)(1)(E).

⁷² 2013 rule § __.10(c)(11)(ii).

in the business of making public welfare investments would result in banking entities being able to provide valuable expertise and services to these entities and to provide funding and assistance to small businesses and low- and moderate-income communities. The agencies also stated their belief that excluding issuers that are in the business of making public welfare investments would allow banking entities to continue to provide capital to community-improving projects and, in some instances, promote capital formation.⁷³

In response to the 2018 proposal, the agencies received one comment stating that the 2013 rule's exclusion for funds that are designed primarily to promote the public welfare does not account for community development investments that are made through investment vehicles. The commenter recommended expressly excluding all investments that qualify for Community Reinvestment Act (CRA) credit, including direct and indirect investments in a community development fund, small business investment company (SBIC), or similar fund.⁷⁴

The OCC's regulations implementing 12 U.S.C. 24(Eleventh) provide that investments that receive consideration as qualified investments under the regulations implementing the CRA (CRA-qualified investments) would also meet the public welfare investment requirements.⁷⁵ The 2013 rule did not expressly incorporate these implementing regulations into the exclusion for public welfare investments. The agencies are requesting comment on whether any change should be made to clarify that all permissible public welfare investments, under any agency's

⁷³ See 79 FR 5698.

⁷⁴ See ABA.

⁷⁵ See 12 CFR 24.3 (stating that, for national banks, an investment that would receive consideration under 12 CFR 25.23 as a "qualified investment" is a public welfare investment); 12 CFR 25.23 (describing the investment test under the regulations implementing the CRA for national banks).

regulation, are excluded from the covered fund restrictions.⁷⁶ For example, the agencies understand that there may be uncertainty regarding how the exclusion for public welfare investments applies to community development investments that are made through fund structures—for example, an investment fund that invests exclusively in SBICs, that is designed to receive consideration as a CRA-qualified investment, and that would be considered a public welfare investment under applicable regulations.

In particular, the agencies request comment on the following:

Question 17. Is the scope of the current public welfare investment fund exclusion properly calibrated? Why or why not? Under what circumstances, if any, have banking entities experienced compliance challenges under Subpart C regarding investments in community development, public welfare, or similar funds that are designed to receive consideration as CRA-qualified investments?

Question 18. Have banking entities avoided making investments that are designed to receive consideration as CRA-qualified investments because they believed that the investment may not satisfy the public welfare investment fund exclusion? If so, what factors have caused uncertainty as to whether an issuer qualifies for the exclusion for public welfare investment funds?

Question 19. In what ways would it promote transparency, clarity, and consistency with other Federal banking regulations if the agencies explicitly exclude from the definition of covered fund any issuer that invests exclusively or substantially in investments that are designed

⁷⁶ A banking entity must have independent authority to make a public welfare investment. For example, a banking entity that is a state member bank may make a public welfare investment to the extent permissible under 12 U.S.C. 338a and 12 C.F.R. 208.22.

to receive consideration as CRA-qualified investments? What policy considerations weigh for or against such an exclusion? What conditions should apply to such an exclusion?

Question 20. Should the agencies establish a separate exclusion for CRA-qualified investments or incorporate such an exclusion into the exclusion for public welfare investments?

Question 21. Rural Business Investment Companies (RBICs)—as defined under 203(1) and 203(m) of the Investment Advisers Act of 1940 (“Advisers Act”)—are companies licensed under the Rural Business Investment Program (RBIP), a program created as a joint initiative between the U.S. Department of Agriculture and the Small Business Administration. The RBIP was designed to promote economic development and job creation in rural communities by investing in companies involved in the production, processing and supply of food and agriculture-related products. Under the implementing regulations, are many RBICs excluded from the definition of covered fund because of the public welfare exclusion or because of another provision?⁷⁷ Should the agencies provide an express exclusion from the definition of covered fund for RBICs, similar to the exclusion for SBICs? Are RBICs substantially similar to SBICs and public welfare companies that banking entities are permitted to make and retain investments in under section 13(d)(1)(E) of the BHC Act? Would excluding RBICs in the same manner that SBICs and public welfare companies are excluded from the definition of covered

⁷⁷ Following enactment of the RBIC Advisers Relief Act of 2018, Pub. L. 115-417 (2019), advisers to solely RBICs and advisers to solely SBICs are exempt from investment adviser registration pursuant to Advisers Act, section 203(b)(8) and 203(b)(7), respectively. The venture capital fund adviser exemption deems RBICs and SBICs to be venture capital funds for purposes of the registration exemption. 15 U.S.C. 80b-3(l). Accordingly, the agencies’ proposed exclusion for certain venture capital funds discussed below, *see infra* section III.C.2, which would require that a fund be a “venture capital fund” as defined in the SEC regulations implementing the registration exemption, could apply to RBICs and SBICs to the extent that they satisfy the other elements of the proposed exclusion.

fund provide certainty regarding the covered fund status of RBICs or serve similar interests, as identified by commenters in response to the 2018 proposal?

Question 22. The Tax Cuts and Jobs Act established the “opportunity zone” program to provide tax incentives for long-term investing in designated economically distressed communities. The program allows taxpayers to defer and reduce taxes on capital gains by reinvesting gains in “qualified opportunity funds” (QOFs) that are required to have at least 90 percent of their assets in designated low-income zones. Do commenters believe that many or all QOFs are excluded from the definition of covered fund under the implementing regulations under the public welfare exclusion or another exclusion or exemption? Should the agencies provide an express exclusion from the definition of covered fund for QOFs? Are QOFs substantially similar to SBICs and public welfare companies that banking entities are permitted to make and retain investments in under section 13(d)(1)(E) of the BHC Act? Would excluding QOFs in the same manner that SBICs and public welfare companies are excluded from the definition of covered fund provide certainty regarding the covered fund status of QOFs or serve similar interests, as identified by commenters in response to the 2018 proposal?

ii. Small Business Investment Companies

Consistent with section 13 of the BHC Act,⁷⁸ the 2013 rule excludes from the definition of covered fund SBICs and issuers that have received notice from the Small Business Administration to proceed to qualify for a license as a SBIC, which notice or license has not been revoked.⁷⁹ The agencies explained in the preamble to the 2013 rule that excluding SBICs from

⁷⁸ See 12 U.S.C. 1851(d)(1)(E) (permitting investments in SBICs).

⁷⁹ See 2013 rule § __.10(c)(11).

the definition of “covered fund” would give appropriate effect to the statutory exemption for investments in SBICs in a way that facilitates national community and economic development objectives.⁸⁰

In response to the 2018 proposal,⁸¹ the agencies received three comments recommending revising the 2013 rule’s exclusion for SBICs to clarify that SBICs that surrender their SBIC licenses when winding down may continue to qualify for the exclusion for SBICs.⁸² Two of these commenters stated that SBICs often surrender their licenses during wind-down, which is when the fund focuses on returning capital to partners.⁸³ One commenter asserted that, during the wind-down phase of an SBIC’s lifecycle, an SBIC license is neither necessary nor a prudent use of partnership funds.⁸⁴ One commenter noted that banking entities that are investors in SBICs generally do not control whether an SBIC surrenders its license. This could raise questions as to whether an issuer that a banking entity invested in when the issuer was an SBIC could become a covered fund for reasons outside the banking entity’s control.⁸⁵ In contrast, another commenter suggested concerns about the SBIC exclusion generally.⁸⁶

The agencies propose to revise the exclusion for SBICs to clarify how the exclusion would apply to SBICs that surrender their licenses during wind-down phases. The proposed rule

⁸⁰ See 79 FR 5698.

⁸¹ 89 FR 33432.

⁸² See Small Business Investors Alliance (SBIA); Capital One et al.; and BB&T Corporation (BB&T).

⁸³ See SBIA and BB&T.

⁸⁴ See BB&T.

⁸⁵ See SBIA.

⁸⁶ Data Boiler.

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 CFR 107.1900 and does not make new investments (other than investments in cash equivalents) after such voluntary surrender.⁸⁷

The agencies believe that continuing to apply the SBIC exclusion to an issuer that has surrendered its SBIC license is appropriate because, absent these revisions, banking entities may become discouraged from investing in SBICs due to concern that an SBIC may become a covered fund during its wind-down phase. As indicated by the statutory exemption for investments in SBICs, section 13 of the BHC Act was not intended to discourage investments in SBICs.⁸⁸

The proposed rule includes conditions designed to ensure that the revised exclusion is not abused. In particular, the requirement that an issuer that has voluntarily surrendered its license does not make new investments (other than investments in cash equivalents) after surrendering its license is intended to ensure that the exclusion would only apply to funds that are actually winding down and not funds that are making new investments (whether wholly new or as follow-on investments to existing investments) or that are engaged in speculative activities. In addition, the exclusion would only apply to an issuer that surrenders its SBIC license in accordance with 13 CFR 107.1900. The agencies note that surrendering a license under 13 CFR 107.1900 requires the prior written approval of the Small Business Administration. Furthermore, because

⁸⁷ For purposes of this exclusion, “cash equivalents” would mean high quality, highly liquid investments whose maturity corresponds to the issuer’s expected or potential need for funds and whose currency corresponds to the issuer’s assets.

⁸⁸ See 12 U.S.C. 1851(d)(1)(E).

the exclusion would only apply to an issuer that voluntarily surrenders its SBIC license, the exclusion would not extend to an issuer if its SBIC license has been revoked.

The agencies request comment on the proposed revisions to the exclusion for SBICs. Specifically, the agencies request comment on the following.

Question 23. Should the agencies revise the SBIC exclusion as proposed? Why or why not? Would the proposed revisions to the SBIC exclusion appropriately address issuers that surrender their SBIC licenses? If not, what changes should be made to the proposal?

Question 24. Should the proposed exclusion for issuers that surrender their SBIC licenses include a requirement that the issuer operate pursuant to a written plan to dissolve within a set period of time, such as five years? Why or why not? If so, what is the appropriate time period?

Question 25. What additional restrictions, if any, should apply to the proposed exclusion for issuers that surrender their SBIC licenses?

Question 26. What specific activities or investments, if any, should an issuer that surrenders its SBIC license be expressly permitted to engage in during wind-down phases, such as follow-on investments in existing portfolio companies and why? What conditions should apply to such activities or investments?

C. Proposed Additional Covered Fund Exclusions

1. Credit Funds

The agencies are proposing to create a new exclusion from the definition of “covered fund” under § ____.10(b) 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. In the preamble to the 2013 rule, the agencies declined to establish an exclusion from the definition of

covered fund for credit funds.⁸⁹ The agencies cited concerns about whether such funds could be distinguished from private equity funds and hedge funds and the possible evasion of the requirements of section 13 of the BHC Act through the availability of such an exclusion. In addition, the agencies suggested that some credit funds would be able to operate using other exclusions from the definition of covered fund in the 2013 rule, such as the exclusion for joint ventures or the exclusion for loan securitizations.⁹⁰

In the 2018 proposal, the agencies issued a broad request for comment on whether to provide new exclusions from the definition of covered fund to more effectively tailor the 2013 rule.⁹¹ Several commenters urged the agencies to establish an exclusion for funds that extend credit to customers in a manner similar to what banking entities are otherwise authorized to provide directly because the credit funds were not able to take advantage of the alternative exclusions noted by the agencies in the 2013 rule’s preamble.⁹² Commenters also offered specific suggestions relating to the scope, requirements of, and restrictions on such an exclusion.

The agencies understand that many credit funds have not been able to utilize the joint venture and loan securitization exclusions⁹³ and are proposing an exclusion for credit funds. A

⁸⁹ 79 FR 5705. The agencies did not request comments specifically on credit funds in the associated 2011 proposed rule. *See* 76 FR 68896–900.

⁹⁰ *Id.*

⁹¹ 83 FR 33471–72. The agencies did not request comments specifically on credit funds in the 2018 proposal.

⁹² *E.g.*, SIFMA; GS; ABA; Financial Services Forum (FSF); and CS.

⁹³ For example, one industry group commenter claimed that “no credit funds have been able to qualify for the exclusion for joint ventures, and very few have been able to qualify for the exclusion for loan securitization vehicles, because these exclusions simply were not tailored for credit funds. In particular, credit funds are generally unable to satisfy the conditions of the loan securitization exclusion because credit funds do not typically issue asset-backed securities, credit

credit fund, for the purposes of the proposed exclusion, is an issuer whose assets consist solely of:

- loans;
- debt instruments;
- related rights and other assets that are related or incidental to acquiring, holding, servicing, or selling loans, or debt instruments; and
- certain interest rate or foreign exchange derivatives.⁹⁴

To ease compliance burdens, several provisions of the proposed exclusion are similar to and modeled on conditions in the loan securitization exclusion. For example, any related rights or other assets held that are securities must be cash equivalents, securities received in lieu of debts previously contracted with respect to loans held or, unique to the proposed credit funds exclusion, certain equity securities (or rights to acquire equity securities) received on customary terms in connection with the credit fund's loans or debt instruments.⁹⁵ Relatedly, any derivatives held by the credit fund must relate to loans, permissible debt instruments, or other rights or assets held and reduce the interest rate and/or foreign exchange risks related to these holdings.⁹⁶ The proposed exclusion also would be broader than the loan securitization exclusion, by providing that a credit fund would be able to transact in certain debt instruments.⁹⁷

funds are managed and to meet the needs of clients, credit funds typically invest in debt securities and warrants.” SIFMA.

⁹⁴ Proposed rule § __.10(c)(15)(i).

⁹⁵ Proposed rule § __.10(c)(15)(i)(C).

⁹⁶ Proposed rule § __.10(c)(15)(i)(D).

⁹⁷ Proposed rule § __.10(c)(15)(i)(B).

As noted above, the proposed exclusion would permit the credit fund to receive and hold a limited amount of equity securities (or rights to acquire equity securities) that are received on customary terms in connection with the credit fund's loans or debt instruments.⁹⁸ The agencies understand that some banking entities are permitted to take as consideration for a loan to a borrower a warrant or option issued by the borrower—which allows the creditor to share in the profits, income, or earnings of the borrower—as an alternative or replacement to interest on an extension of credit.⁹⁹ To ensure that an extension of credit may be subject to similar conditions, regardless of form, the agencies believe that excluded credit funds should be able to hold certain equity instruments, subject to appropriate conditions. The agencies are inviting comment on the nature and scope of such conditions. Although the agencies are not proposing a specific quantitative limit on equity securities (or rights to acquire equity securities) in the proposed rule, the agencies expect that such a limit may be appropriate, and are considering imposing such a limit in a final rule. The agencies are thus soliciting comment, below, about the terms of any quantitative limit on equity securities (or rights to acquire equity securities), and the method for calculating such a limit.

The exclusion also would be subject to certain additional restrictions to ensure that the issuer is actually engaged in providing credit and credit intermediation and is not operated for the purpose of evading the provisions of section 13 of the BHC Act.¹⁰⁰ Under the proposal, a credit fund would not be a covered fund, provided that:

⁹⁸ Proposed rule § __.10(c)(15)(i)(C)(I)(iii).

⁹⁹ See 12 CFR 7.1006. *See also* SIFMA.

¹⁰⁰ Proposed rule § __.10(c)(15)(iv)–(vi).

- the fund does not engage in activities that would constitute proprietary trading, as defined in § __.3(b)(1)(i) of the rule, as if the fund were a banking entity;¹⁰¹ and
- the fund does not issue asset-backed securities.¹⁰²

In addition, a banking entity would not be able to rely on the credit fund exclusion unless certain conditions were met. If a banking entity sponsors or serves 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), 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.¹⁰³ Likewise, a banking entity would not be permitted to rely on the credit fund exclusion if it guarantees the performance of the fund,¹⁰⁴ or if 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.¹⁰⁵ Furthermore, a banking entity's investment in and relationship with a credit fund would be required to comply with the limitations in section __.14 (except the banking entity would be permitted to acquire and retain any ownership interest in the credit fund), and the 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.¹⁰⁶ A banking entity's investment in and

¹⁰¹ Proposed rule § __.10(c)(15)(ii)(A). For the avoidance of doubt, a credit fund would not be able to elect a different definition of proprietary trading or trading account.

¹⁰² Proposed rule § __.10(c)(15)(ii)(B).

¹⁰³ Proposed rule § __.10(c)(15)(iii).

¹⁰⁴ Proposed rule § __.10(c)(15)(iv).

¹⁰⁵ *Id.*

¹⁰⁶ Proposed rule § __.10(c)(15)(v)(A).

relationship with a credit fund also would be required to comply with applicable safety and soundness standards.¹⁰⁷ Finally, 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.¹⁰⁸

The agencies believe that the proposed credit fund exclusion would (1) address the application of the covered fund provisions to credit-related activities in which banking entities are permitted to engage directly and (2) be consistent with and effectuate Congress's intent that section 13 of the BHC Act not limit or restrict banking entities' ability to sell loans.¹⁰⁹ The agencies also believe the proposed credit fund exclusion may effectively address concerns the agencies expressed in the preamble to the 2013 rule about the administrability and evasion of section 13 of the BHC Act. Banking entities already have experience using and complying with the loan securitization exclusion. Establishing an exclusion for credit funds based on the framework provided by the loan securitization exclusion would allow banking entities to provide traditional extensions of credit regardless of the specific form, whether directly via a loan made by a banking entity, or indirectly through an investment in or relationship with a credit fund that transacts primarily in loans and certain debt instruments.

The proposed credit fund exclusion limits the universe of potential funds that could rely on the exclusion by clearly specifying the types of activities those funds may engage in. Excluded credit funds could transact in or hold only loans, permissible debt instruments, and

¹⁰⁷ Proposed rule § __.10(c)(15)(v)(B).

¹⁰⁸ 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 CFR 217.22.

¹⁰⁹ 12 U.S.C. 1851(g)(2).

certain related rights or assets. These financial products, and the regulations delimiting the use thereof, are well-known and should not raise administrability and evasion concerns. Similarly, the requirement that the credit fund not engage in activities that would constitute proprietary trading under section 13 of the BHC Act and implementing regulations should help to ensure that credit extensions that are bought and sold are held for the purpose of facilitating the extension of credit and not for the purpose of evading the requirements of section 13. Finally, the restrictions on guarantees and other limitations should eliminate the ability and incentive for either the banking entity sponsoring a credit fund or any affiliate to provide additional support beyond the ownership interest retained by the sponsor. Thus, the agencies expect that, together, the proposed criteria for the credit fund exclusion would prevent a banking entity having any incentive to bail out such funds in periods of financial stress or otherwise expose the banking entity to the types of risks that the covered fund provisions of section 13 were intended to address.

The agencies request comment on all aspects of the proposed credit fund exclusion.

Question 27. Is the proposed rule's approach to a credit fund exclusion appropriate and effective? Why or why not? Do the conditions imposed on the proposed exclusion effectively address the concerns about administrability and evasion that the agencies expressed in the preamble to the 2013 rule?

Question 28. What types of loans and permissible debt instruments or some subset of those assets, if any, should a credit fund be able to hold? Are the definitions used in the proposed exclusion appropriate and clear?

Question 29. The agencies believe it could be appropriate to permit credit funds to hold a small amount of non-loan and non-debt assets, such as warrants or other equity-like interests

directly related to the other permitted assets, subject to appropriate conditions. Should credit funds be able to hold small amounts of equity securities (or rights to acquire equity securities) received on customary terms in connection with the credit fund's loans or debt instruments? If so, what should be the quantitative limit on permissible non-loan and non-debt assets? Should the limit be five or ten percent of assets, or some other amount? How should such quantitative limit be calculated? Does the holding of a certain amount of equity securities (or rights to acquire equity securities) raise concerns that banking entities may use credit funds to evade the limitations and prohibitions in section 13 of the BHC Act? Why or why not? For example, under the proposal, could the holdings of an excluded fund be predominantly equity securities (or rights to acquire equity securities) received on customary terms in connection with the credit fund's loans or debt instruments? If so, how?

Question 30. The proposed credit fund exclusion would permit excluded credit funds to hold related rights and other assets that are related or incidental to acquiring, holding, servicing, or selling loans or debt instruments, provided that each right or asset that is a security meets certain requirements. Should credit funds be allowed to hold such related rights and other assets? Are these assets necessary for the proper functioning of a credit fund? Are the requirements regarding rights or assets that are securities applicable to the holdings of credit funds or otherwise appropriate?

Question 31. Is the list of permitted securities appropriately scoped, overbroad, or under-inclusive? Why or why not? Should the list of permitted securities be modified? If so, how and why?

Question 32. The proposal provides that any interest rate or foreign exchange derivatives held by the credit fund adhere to certain requirements. Should credit funds be allowed to hold

these, or any other type of derivatives? Are the requirements that the written terms of the derivatives directly relate to assets held and that the derivatives reduce the interest rate and/or foreign exchange risks related to the assets held applicable to the holdings of credit funds generally? Are such requirements otherwise appropriate? Why or why not?

Question 33. Which safety and soundness standards, if any, should be referenced in the credit fund exclusion? Should the agencies reference the safety and soundness standards codified in the banking agencies' regulations, e.g., 12 CFR part 30, 12 CFR part 364, or other safety and soundness standards? Safety and soundness standards can vary depending on the type of banking entity. Is there a universally applicable standard that would be more appropriate, such as standards applicable to insured depository institutions?

Question 34. Is the application of sections __.14 and __.15 to the proposed credit fund exclusion appropriate? Why or why not? Should a banking entity that sponsors or serves as an investment adviser to a credit fund be required to comply with the limitations imposed by both sections __.14(a) and (b)? Why or why not?

Question 35. Is it appropriate to require a banking entity that sponsors or serves as an investment adviser or commodity trading advisor to a credit fund, to comply with the disclosure requirements of § __.11(a)(8), as if the credit fund were a covered fund? Why or why not?

Question 36. Is the definition of proprietary trading in the credit fund exclusion appropriately scoped, overbroad, or under-inclusive? Why or why not? If the definition is not appropriately scoped, is there an alternative definition of proprietary trading? Should credit funds sponsored by, or that have as an investment adviser, a banking entity be able or be required to use the associated banking entity's definition of proprietary trading, for the purposes of this

exclusion? Why or why not? Would such an approach impose undue compliance burdens? If so, what are such burdens?

Question 37. Should the agencies establish additional provisions to prevent evasion of section 13 of the BHC Act? Why or why not? If so, what requirements would be appropriate and properly balance providing firms with flexibility to facilitate extensions of credit and ensuring compliance with section 13 of the BHC Act? For example, should the agencies impose quantitative limitations, additional capital charges, control restrictions, or other requirements on use of the credit fund exclusion?

Question 38. The proposed exclusion for credit funds is similar to the current exclusion for loan securitizations. Should the agencies combine the proposed credit fund exclusion with the current loan securitization exclusion? If so, how? What would be the benefits and drawbacks of combining the exclusions or maintaining separate exclusions for each type of activity? If the two exclusions remain separate, should the proposed credit fund exclusion contain a requirement that a credit fund not issue asset-backed securities? Why or why not?

2. Venture Capital Funds

Under the implementing regulations, venture capital funds that invest in small businesses and start-up businesses that would be investment companies but for the exclusion contained in section 3(c)(1) or 3(c)(7) of the Investment Company Act are covered funds unless they otherwise qualify for an exclusion. The agencies are proposing to add an exclusion from the definition of “covered fund” under §__.10(b) of the rule that would allow banking entities to acquire or retain an ownership interest in, or sponsor, certain venture capital funds to the extent the banking entity is permitted to engage in such activities under otherwise applicable law. The exclusion would be available with respect to “qualifying venture capital funds,” which the

proposal defines as an issuer that meets the definition in 17 CFR 275.203(l)-1 and that meets several additional criteria specified below.

Contemporaneous with the passage of the Dodd-Frank Act, multiple Members of Congress made statements indicating that section 13 of the BHC Act should not restrict the activities of venture capital funds.¹¹⁰ Several of these Members of Congress noted that properly conducted venture capital funds do not present the same concerns at which section 13 of the BHC Act was directed and can promote the public interest and job creation.¹¹¹ In addition, in

¹¹⁰ See 156 Cong. Rec. E1295 (daily ed. July 13, 2010) (statement of Rep. Eshoo) (“the purpose of the Volcker Rule is to eliminate risk-taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest... Venture capital funds do not pose the same risk to the health of the financial system. They promote the public interest by funding growing companies critical to spurring innovation, job creation, and economic competitiveness. I expect the regulators to use the broad authority in the Volcker Rule wisely and clarify that funds... such as venture capital funds, are not captured under the Volcker Rule and fall outside the definition of ‘private equity.’”); 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Boxer) (recognizing “the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies” and that “the intent of the rule is not to harm venture capital investment.”); 156 Cong. Rec. S5905 (daily ed. July 15, 2010) (statement of Sen. Dodd) (confirming “the purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest” and stating “properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619[d][1](J)...”); 156 Cong. Rec. S6242 (daily ed. July 26, 2010) (statement of Sen. Scott Brown) (“One other area of remaining uncertainty that has been left to the regulators is the treatment of bank investments in venture capital funds. Regulators should carefully consider whether banks that focus overwhelmingly on lending to and investing in start-up technology companies should be captured by one-size-fits-all restrictions under the Volcker rule. I believe they should not be. Venture capital investments help entrepreneurs get the financing they need to create new jobs. Unfairly restricting this type of capital formation is the last thing we should be doing in this economy.”).

¹¹¹ See 156 Cong. Rec. E1295 (daily ed. July 13, 2010) (statement of Rep. Eshoo); 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Boxer); 156 Cong. Rec. S5905 (daily ed. July 15, 2010) (statement of Sen. Dodd); 156 Cong. Rec. S6242 (daily ed. July 26, 2010) (statement of Sen. Scott Brown).

accordance with section 13(b)(1) of the BHC Act, the Financial Stability Oversight Council (FSOC) released a report providing recommendations concerning implementation of section 13.¹¹² The FSOC Report noted that several commenters recommended excluding venture capital funds from the definition of “hedge fund” and “private equity fund” because the nature of venture capital funds is fundamentally different from such other funds and because they promote innovation.¹¹³ The FSOC Report stated that the treatment of venture capital funds was a significant issue and noted that the SEC had recently proposed rules distinguishing the characteristics and activities of venture capital funds from other private funds.¹¹⁴ The FSOC Report recommended that the agencies carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in section 3(c)(1) or 3(c)(7) and consider whether it would be appropriate for the regulations implementing section 13 to adopt a narrower definition in some cases.¹¹⁵

In the 2011 proposed rule, the agencies requested comment on whether to exclude venture capital funds from the definition of “covered fund.”¹¹⁶ The agencies received several comments supporting such an exclusion and two comments opposing such an exclusion,¹¹⁷ but declined to explicitly exclude venture capital funds from the definition of “covered fund” in the

¹¹² See Financial Stability Oversight Council, Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (Jan. 18, 2011), available at <https://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20org.pdf>. (FSOC Report).

¹¹³ See *id.*

¹¹⁴ See *id.*

¹¹⁵ See *id.*

¹¹⁶ See 76 FR 68915.

¹¹⁷ See 79 FR 5703-04.

2013 rule.¹¹⁸ The agencies indicated at the time that they did not believe the statutory language of section 13 supported providing an exclusion for venture capital funds.¹¹⁹ The agencies explained that this view was based on an understanding that Congress treated venture capital funds as a subset of private equity funds in other contexts and that Congress did not adopt an express exclusion for venture capital funds in section 13 of the BHC Act.¹²⁰ Specifically, the agencies cited to congressional reports related to section 402 of the Dodd-Frank Act that characterized venture capital funds as “a subset of private investment funds specializing in long-term equity investment in small or start-up businesses.”¹²¹ The agencies further stated that it appeared that the activities and risk profiles for banking entities regarding sponsorship of, and investment in, private equity and venture capital funds were not readily distinguishable.¹²²

¹¹⁸ *See id.*

¹¹⁹ *See id.*

¹²⁰ *See id.*

¹²¹ *Id.* (quoting S. Rep. No. 111–176 (2010)). *See also* H. Rep. No. 111-517 (2010) (indicating that venture capital funds are subsets of “private funds”). However, the agencies did not address the difference in terminology that Congress used in section 402 of the Dodd-Frank Act (“private funds”) and section 619 (“hedge funds” and “private equity funds”). Nor did the agencies address the different statutory definitions of these terms. Section 402 defines “private fund” as “an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act.” Section 619 defines “hedge fund or private equity fund” as “an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act, *or such similar funds as the [agencies] may, by rule...determine.*” (emphasis added).

¹²² *See* 79 FR 5704. The agencies do not believe the fact that Congress expressly distinguished these funds from other types of private funds in other provisions of the Dodd-Frank Act is dispositive. In this context, we do not believe that the differences in how the terms private equity fund and venture capital fund are used in the Dodd-Frank Act prohibit this proposal. The agencies believe it is reasonable under the authority given to the agencies under the statute to exclude these funds from the definition of “covered fund.”

In 2017, the U.S. Department of the Treasury issued a report stating that the definition of “covered fund” is overly broad and that the covered fund provisions are not well-tailored to the objectives of section 13 of the BHC Act.¹²³ The report stated that changes to the covered fund provisions would “greatly assist in the formation of venture and other capital that is critical to fund economic growth opportunities.”¹²⁴ In the 2018 proposal, the agencies requested comment on whether to exclude from the definition of “covered fund” issuers that do not meet the definition of “hedge fund” or “private equity fund” in the SEC’s Form PF.¹²⁵ The agencies noted that a venture capital fund, as defined in rule 203(I)–1 under the Advisers Act, is not a “private equity fund” or “hedge fund,” as those terms are defined in Form PF and requested comment on whether to include venture capital funds within the definition of “covered fund” if the agencies adopted a definition of covered fund based on the definitions in Form PF.¹²⁶

In response to the 2018 proposal, the agencies received several comments supporting excluding venture capital funds from the definition of covered fund.¹²⁷ Commenters stated that the legislative record does not indicate that Congress intended to restrict the activities of venture capital funds and that Members of Congress supported excluding venture capital funds from the definition of covered fund.¹²⁸ Commenters further stated that venture capital funds engage in

¹²³ See U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions* at 77 (June 2017).

¹²⁴ See *id.*

¹²⁵ See 83 FR 33478.

¹²⁶ See *id.*

¹²⁷ See ABA; BPI; IIB; SIFMA; Crapo et al.; Hultgren; Hensarling et al; National Venture Capital Association (NVCA); and Center for American Entrepreneurship (CAE).

¹²⁸ See ABA; BPI; Representative Hultgren; NVCA; and Center for Capital Markets Competitiveness (CCMC).

long-term investments that promote growth, capital formation, and competitiveness.¹²⁹ Some commenters specifically recommended using the definition of “venture capital fund” in rule 203(l)-1 under the Advisers Act to determine the scope of a venture capital fund exclusion.¹³⁰ One commenter argued that venture capital funds should be treated the same as private equity funds.¹³¹ Two commenters opposed excluding venture capital funds from the definition of covered fund.¹³² In addition, several commenters opposed redefining “covered fund” using the definitions of “hedge fund” and “private equity fund” in Form PF.¹³³ Two commenters supported using the definitions in Form PF as a basis for excluding certain issuers from the definition of covered fund.¹³⁴ In addition, the agencies received several comments stating the rule should allow banking entities to invest in funds that engage only in long-term activities, including venture capital investments, that would be permissible for the banking entity to engage in directly.¹³⁵

As discussed in detail below, the agencies are proposing to exclude from the definition of “covered fund” qualifying venture capital funds. The proposal would define a qualifying venture capital fund as an issuer that:

- is a venture capital fund as defined in 17 CFR 275.203(l)-1; and

¹²⁹ See ABA; BPI; Representative Hultgren; NVCA; Representatives Hensarling et al.; and CAE.

¹³⁰ See Representative Hultgren and NVCA.

¹³¹ See AIC.

¹³² See Occupy the SEC and Data Boiler.

¹³³ See, e.g., Americans for Financial Reform; AIC; and SIFMA.

¹³⁴ See Association for Corporate Growth and FI.

¹³⁵ See e.g., ABA; NVCA; AIC; CCMC; and Committee on Capital Markets Regulation.

- does not engage in any activity that would constitute proprietary trading, under §__.3(b)(1)(i), as if it were a banking entity.

With respect to any banking entity that acts as a sponsor, investment adviser, or commodity trading adviser to the issuer, the banking entity would be required to:

- provide in writing to any prospective and actual investor the disclosures required under Section __.11(a)(8), as if the issuer were a covered fund; and
- ensure that the activities of the issuer 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.

In addition, a banking entity that relies on this exclusion would not, directly or indirectly, be permitted to guarantee, assume, or otherwise insure the obligations or performance of the issuer.

Finally, the proposed exclusion would require a banking entity's ownership interest in or relationship with a qualifying venture capital fund to:

- comply with the limitations imposed in §__.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and §__.15 of the implementing regulations, as if the issuer were a covered fund; and
- be conducted in compliance with, and subject to, applicable banking laws and regulations, including applicable safety and soundness standards.

These requirements are intended to ensure that banking entity investments in qualifying venture capital funds are consistent with the purposes of section 13 of the BHC Act. First, a

qualifying venture capital fund must be a venture capital fund as defined in 17 CFR 275.203(l)-1.

The SEC has defined “venture capital fund” as any private fund¹³⁶ that:

- Represents to investors and potential investors that it pursues a venture capital strategy;
- Immediately after the acquisition of any asset, other than qualifying investments or short-term holdings, holds no more than 20 percent of the amount of the fund’s aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, consistently applied by the fund;
- Does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the private fund’s aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee by the private fund of a qualifying portfolio company’s obligations up to the amount of the value of the private fund’s investment in the qualifying portfolio company is not subject to the 120 calendar day limit;
- Only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and

¹³⁶ For purposes of 17 CFR 275.203(l)-1, “private fund” is defined as “an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act.” 15 U.S.C. 80b-2(a)(29).

- Is not registered under section 8 of the Investment Company Act of 1940 . . . , and has not elected to be treated as a business development company pursuant to section 54 of that Act¹³⁷

“Qualifying investment” is defined in the SEC’s regulation to be: (1) an equity security issued by a qualifying portfolio company that has been acquired directly by the private fund from the qualifying portfolio company; (2) any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company described in (1); or (3) any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, as defined in section 2(a)(24) of the Investment Company Act, or a predecessor, and is acquired by the private fund in exchange for an equity security described in (1) or (2).¹³⁸

“Qualifying portfolio company,” in turn, is defined in the SEC’s regulation to be a company that: (1) at the time of any investment by the private fund, is not reporting or foreign traded and does not control, is not controlled by or under common control with another company, directly or indirectly, that is reporting or foreign traded; (2) does not borrow or issue debt obligations in connection with the private fund’s investment in such company and distribute to the private fund the proceeds of such borrowing or issuance in exchange for the private fund’s investment; and (3) is not an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by 17 CFR 270.3a-7, or a commodity pool.¹³⁹ The SEC explained that the definitions of “qualifying investment” and “qualifying

¹³⁷ 17 CFR 275.203(l)-1(a).

¹³⁸ 17 CFR 275.203(l)-1(c)(3).

¹³⁹ 17 CFR 275.203(l)-1(c)(4).

portfolio company” reflect the typical characteristics of investments made by venture capital funds and that these definitions work together to cabin the definition of venture capital fund to only the funds that Congress understood to be venture capital funds during the passage of the Dodd-Frank Act.¹⁴⁰

In the preamble to the regulations adopting this definition of venture capital fund, the SEC explained that the definition’s criteria distinguish venture capital funds from other types of funds, including private equity funds and hedge funds. For example, the SEC explained that it understood the criteria for “qualifying portfolio companies” to be characteristic of issuers of portfolio securities held by venture capital funds and, taken together, would operate to exclude most private equity funds and hedge funds from the venture capital fund definition.¹⁴¹ The SEC also explained that the criteria for “qualifying investments” under the SEC’s regulation would help to differentiate venture capital funds from other types of private funds, such as leveraged buyout funds.¹⁴² Moreover, the SEC explained that these criteria reflect the Congressional understanding that venture capital funds are less connected with the public markets and therefore may have less potential for systemic risk.¹⁴³ The SEC further explained that its regulation’s

¹⁴⁰ See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, 76 FR 39646, 39657 (Jul. 6, 2011).

¹⁴¹ 76 FR 39656.

¹⁴² See, e.g., 76 FR 39653 (explaining that a limitation on secondary market purchases of a qualifying portfolio company’s shares would recognize “the critical role this condition played in differentiating venture capital funds from other types of private funds”).

¹⁴³ 76 FR 39648 (“[T]he proposed definition of venture capital fund was designed to . . . address concerns expressed by Congress regarding the potential for systemic risk.”); 76 FR 39656 (“Congressional testimony asserted that these funds may be less connected with the public markets and may involve less potential for systemic risk. This appears to be a key consideration by Congress that led to the enactment of the venture capital exemption. As we discussed in the Proposing Release, the rule we proposed sought to incorporate this Congressional understanding

restriction on the amount of borrowing, debt obligations, guarantees or other incurrence of leverage was appropriate to differentiate venture capital funds from other types of private funds that may engage in trading strategies that use financial leverage and may contribute to systemic risk.¹⁴⁴

The agencies believe the SEC’s rationale for adopting this definition of venture capital fund could also support using this definition as the foundation for an exclusion from the definition of “covered fund.” First, this definition helps to distinguish the investment activities of venture capital funds from those of hedge funds and private equity funds, which was one of the agencies’ primary concerns in declining to adopt an exclusion for venture capital funds in the 2013 rule. Second, this definition includes criteria reflecting the characteristics of venture capital funds that the agencies believe may pose less potential risk to a banking entity sponsoring or investing in venture capital funds and to the financial system – specifically, the smaller role of leverage financing and a lesser degree of interconnectedness with public markets.¹⁴⁵ These characteristics would help to address the concern expressed in the preamble to the 2013 rule that the activities and risk profiles for banking entities regarding sponsorship of, and investment in, venture capital fund activities are not readily distinguishable from those funds that section 13 of the BHC Act was intended to capture.

of the nature of investments of a venture capital fund, and these principles guided our consideration of the proposed venture capital fund definition.”).

¹⁴⁴ 76 FR 39662. *See also* 76 FR 39657 (“We proposed these elements of the qualifying portfolio company definition because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee report, and the testimony before Congress that stressed the lack of leverage in venture capital investing.”).

¹⁴⁵ *See supra* notes 106 and 107.

While the SEC's regulatory definition in 17 CFR 275.203(l)-1 would form the base of the proposed exclusion for qualifying venture capital funds, the proposed exclusion includes additional criteria that would help promote the specific purposes of section 13 of the BHC Act. In particular, a qualifying venture capital fund would not be permitted to engage in any activity that would constitute proprietary trading under § __.3(b)(1)(i) as if the fund were a banking entity. This requirement would promote one of the purposes of the covered fund provisions in section 13 of the BHC Act, which was to prevent banking entities from circumventing the proprietary trading prohibition through fund investments.¹⁴⁶ Under this requirement, a qualifying venture capital fund could not engage in any activities that are principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from such purchases or sales.

The agencies are considering an additional restriction for which they are seeking specific comment. Under this additional restriction, and notwithstanding 17 CFR 275.203(l)-1(a)(2), the venture capital fund exclusion would be limited 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. The agencies are considering what specific threshold would be appropriate. For example, the agencies are considering whether a limit of \$50 million in annual revenue would be appropriate, or whether a higher or lower limit would help to appropriately differentiate venture capital funds from the types of funds that section 13 of the BHC Act was intended to address.

¹⁴⁶ See, e.g., Treasury Report at 77 and FSOC Report at 6.

A banking entity that serves as a sponsor, investment adviser, or commodity trading advisor to a qualifying venture capital fund would be required to provide the disclosures required under §__.11 (a)(8) to prospective and actual investors in the fund. In addition, any banking entity that relies on the exclusion would not be permitted to, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the qualifying venture capital fund. These requirements would promote yet another goal of section 13 of the BHC Act, which was to prevent banking entities from bailing out funds that they sponsor or advise.¹⁴⁷

A banking entity that serves as a sponsor, investment adviser, or commodity trading advisor to a qualifying venture capital fund also must ensure the fund's activities 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. Therefore, a banking entity could not rely on this exclusion to sponsor an investment fund that exposes the banking entity to the type of high-risk trading and investment activities that the covered fund provisions of section 13 of the BHC Act were intended to restrict. Further, a banking entity's investment in or relationship with a qualifying venture capital fund would be subject to §__.14 (except the banking entity may acquire and retain any ownership interest in the fund in accordance with the terms of the exclusion) and §__.15 of the implementing regulations, as if the fund were a covered fund. These limitations would help to ensure that the risk a banking entity takes on as a result of its investment in or relationship with a qualifying venture capital fund remains appropriately limited. Like the restrictions on guarantees described above, applying the requirements in §__.14 would restrict a banking entity that sponsors or advises the fund from providing additional support or bailing out the fund. Applying the requirements in §__.15 would ensure

¹⁴⁷ See Treasury Report at 77 and FSOC Report at 6.

that the fund does not expose the banking entity to high-risk assets or high-risk trading strategies. In particular, to the extent a fund would expose a banking entity to a high-risk asset or high-risk trading strategy (or otherwise engage in proprietary trading), the fund would not be a qualifying venture capital fund. Therefore, prior to making an investment in a qualifying venture capital fund, a banking entity would need to ensure that the fund's investment mandate and strategy would satisfy the requirements of §__.15. In addition, a banking entity would need to monitor the activities of a qualifying venture capital fund to ensure it satisfies these requirements on an ongoing basis.

The agencies believe that qualifying venture capital funds meeting each of these requirements would not raise the type of concerns that were the target of section 13 of the BHC Act. The proposed exclusion, including incorporation of the SEC's regulatory venture capital fund definition in 17 CFR 275.203(l)-1, should also address the concerns the agencies expressed in the preamble to the 2013 rule that the activities and risk profiles for banking entities regarding sponsorship of, and investment in, venture capital funds are not readily distinguishable from those of funds that section 13 of the BHC Act was intended to capture. Accordingly, the agencies believe the foregoing requirements could give effect to the language and purpose of section 13 of the BHC Act without allowing banking entities to evade the requirements of section 13. The agencies further believe that permitting banking entities to invest in and have certain relationships with qualifying venture capital funds would be consistent with statements by Members of Congress that were made contemporaneously with passage of the Dodd-Frank Act.¹⁴⁸

¹⁴⁸ See *supra* note 11010.

The agencies believe that properly-conducted activities involving these types of venture capital funds could promote and protect the safety and soundness of banking entities and the financial stability of the United States. Qualifying venture capital funds could allow banking entities to diversify their permissible investment activities, and like other exclusions provided in the 2013 rule, allow banking entities to share the costs and risks of their permissible investment activities with third-party investors.¹⁴⁹ Investments in qualifying venture capital funds could allow banking entities to allocate available resources to a more diverse array of long-term investments in a broader range of geographic areas, industries and sectors than the banking entity may be able to access directly.

Banking entity investments in qualifying venture capital funds may benefit the broader financial system by improving the flow of financing to small businesses and start-ups and thus may promote and protect the financial stability of the United States. Permitting these types of investments would be consistent with the Treasury Department’s June 2017 report, which said such fund investments “can greatly assist in the formation of venture and other capital that is critical to fund economic growth opportunities.”¹⁵⁰ Similarly, the agencies recognized the economic benefits of allowing banking entities to make venture capital-style investments in the preamble to the 2013 rule, despite not adopting an exclusion for such funds.¹⁵¹ Further, it is possible that permitting banking entities to extend financing to businesses through qualifying

¹⁴⁹ 79 FR 5681.

¹⁵⁰ Treasury Report at 77.

¹⁵¹ 79 FR 5704 (“While the final rule does not provide a separate exclusion for venture capital funds from the definition of covered fund, the [a]gencies recognize that certain venture capital investments by banking entities provide capital and funding to nascent or early-stage companies and small businesses and also may provide these companies expertise and services. Other provisions of the final rule or the statute may facilitate, or at least not impede, other forms of investing that may provide *the same or similar benefits.*”) (emphasis added).

venture capital funds would allow banking entities to compete more effectively with non-banking entities that are not subject to the same prudential regulation or supervision as banking entities subject to section 13 of the BHC Act. In this respect, the proposal could allow a larger volume of permissible banking and financial activities to occur in the regulated banking system.

In addition, it is widely noted that the availability of venture and other financing from funds is not uniform throughout the United States. In particular, it is noted that such funding is generally available on a competitive basis for companies with a significant presence in certain geographic regions (e.g., the New York metropolitan area, the Boston metropolitan area and “Silicon Valley” and surrounding areas).¹⁵² In this respect, the proposal could allow banking entities with a presence in and knowledge of the areas where venture capital and other types of financing are less readily available to businesses to provide this type of financing in those areas.

For all of these reasons, the agencies believe the proposal could promote the benefits of long-term investment that the agencies and Members of Congress have previously recognized, while also addressing the concerns that were the target of the funds prohibition in section 13 of the BHC Act. The agencies are seeking comment on whether to exclude other types of funds that, like qualifying venture capital funds, provide important capital to businesses through long-term investments and do not engage in proprietary trading and other activities that section 13 of the BHC Act was intended to prohibit.

The agencies are requesting comment on the proposal to exclude qualifying venture capital funds from the covered fund definition, in particular:

¹⁵² See, e.g., Richard Florida, *Venture Capital Remains Highly Concentrated in Just a Few Cities*, CITYLAB (Oct. 3, 2017), available at <https://www.citylab.com/life/2017/10/venture-capital-concentration/539775/>; PRICEWATERHOUSECOOPERS & CB INSIGHTS, *MoneyTree Report (Q3 2019)*, available at: <https://www.pwc.com/us/en/moneytree-report/assets/moneytree-report-q3-2019.pdf>.

Question 39. Is the proposed exclusion for qualifying venture capital funds appropriate?

Why or why not?

Question 40. Does the proposed exclusion for qualifying venture capital funds include the appropriate vehicles? Why or why not? If not, how should the agencies expand or narrow the vehicles for which banking entities would be permitted to make use of the exclusion? What modifications to the proposed exclusion would be appropriate and why?

Question 41. Are the proposed conditions on the proposed exclusion for qualifying venture capital funds appropriate? Why or why not? If not appropriate, how should the agencies modify the conditions, and why?

Question 42. Would permitting banking entities to invest in or sponsor a qualifying venture capital fund promote and protect the safety and soundness of banking entities and the financial stability of the United States? What data is available to support an argument that venture capital funds would or would not promote and protect the safety and soundness of banking entities and the financial stability of the United States?

Question 43. Are the requirements for a qualifying venture capital fund sufficient to distinguish these types of funds from covered funds? Are there any additional standards or requirements that should apply to a qualifying venture capital fund? If so, what are they and why should they apply?

Question 44. Should the additional proposed revenue requirement be added to the venture capital fund exclusion to help ensure that the investments made by excluded venture capital funds are truly made in small and early-stage companies? Why or why not? If the additional restriction is added, is \$50 million an appropriate annual revenue limit? If not, what would be an appropriate revenue limit? Is there a metric other than annual gross revenue, such

as amount of time in operation, that would serve as a better indicator of whether an investment in a company should allow a venture capital fund to qualify for the exclusion?

Question 45. Should the proposed venture capital fund exclusion require that 100 percent of the fund's holdings, other than short-term holdings, be in qualifying investments instead of the 80 percent that is required under 17 CFR 275.203(l)-1(a)(2)? Why or why not?

Question 46. Are there provisions or conditions of the definition under rule 203(l)-1 under the Advisers Act that are inappropriate for purposes of determining an exclusion from the "covered fund" definition in § ____.10? If so, please explain why the purposes of an exclusion from the "covered fund" definition should lead the agencies to exclude a provision or condition, such as paragraph (a)(2), of the definition under rule 203(l)-1 under the Advisers Act.

Question 47. How would a banking entity ensure the activities of a qualifying venture capital fund are consistent with the safety and soundness standards that apply to the banking entity? Are the standards and requirements for a banking entity that acts as a sponsor, investment adviser, or commodity trading advisor to a qualifying venture capital fund appropriate to apply to a qualifying venture capital fund? Are there any additional standards or requirements that should apply to a banking entity that acts as a sponsor, investment adviser, or commodity trading advisor to a qualifying venture capital fund? If so, what are they, and why should they apply?

Question 48. A banking entity that sponsors or advises a qualifying venture capital fund would be required to comply with the limitations imposed by sections §§ ____.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and ____.15 of the 2013 rule, as if the qualifying venture capital fund were a covered fund. Is the application of these sections to the proposed venture capital fund exclusion appropriate? Why or why not?

Question 49. Is it sufficiently clear what kind of assets or investments would result in a conflict of interest or an exposure to a high-risk asset or high-risk trading strategy in the context of a qualifying venture capital fund? Should the agencies provide additional parameters regarding the types of assets and strategies that could result in such exposure in this context?

Question 50. Should the agencies exclude from the definition of covered fund, or otherwise permit the activities of, certain long-term investment funds that would not be qualifying venture capital funds? For example, should the agencies provide an exclusion for issuers (1) that make long-term investments that a banking entity could make directly, (2) that hold themselves out as entities or arrangements that make investments that they intend to hold for a set minimum time period, such as two years, (3) whose relevant offering and governing documents reflect a long-term investment strategy, and (4) that meet all other requirements of the proposed qualifying venture capital fund exclusion (other than that the issuers would be venture capital funds as defined in 17 CFR 275.203(l)-1)? Would the rationale for excluding qualifying venture capital funds also extend to such long-term investment funds? Why or why not? If the agencies were to adopt an exclusion for long-term investment funds, should the agencies impose safeguards on such an exclusion? If so, what safeguards should the agencies impose, and why? Would such an exclusion promote and protect the safety and soundness of the banking entity and the financial stability of the United States? If so, how?

Question 51. Is there evidence that the covered fund provisions have caused banking entities to make more standalone direct balance sheet investments? If so, have these investments increased or decreased risk to banking entities?

Question 52. Is there evidence that the covered fund provisions have negatively impacted the provision of financing? If so, is this impact non-uniform? For example, are effects more

acute in certain geographic areas or in certain industries? To the extent negative effects are asymmetric by geography or otherwise, would the proposal effectively address these asymmetries? Is there evidence that the covered fund provisions have caused end-users to seek financing from non-banking entities? If so, would the proposed exclusion for qualifying venture capital funds help to address these impacts?

3. Family Wealth Management Vehicles

The agencies are proposing to exclude from the definition of “covered fund” under §__.10(b) of the rule any entity that acts as a “family wealth management vehicle.” The proposed family wealth management vehicle exclusion would be available to an entity that: (1) if organized as a trust, the grantor(s) of the entity are all family customers and, (2) if not organized as a trust, a majority of the voting interests in the entity are owned (directly or indirectly) by family customers; and the entity is owned only by family customers and up to 3 closely related persons of the family customers.¹⁵³ In response to the 2018 proposal, commenters raised concerns that family wealth management vehicles were not specifically excluded from the covered fund definition following the adoption of the 2013 rule or in the 2018 proposed rule.¹⁵⁴ Commenters stated that family wealth management vehicles are typically designed to facilitate family wealth management, estate planning, and other similar objectives and may take a variety of legal forms, including trusts, limited liability companies, limited

¹⁵³ Under § ____.10(c)(17)(iii)(A) of the proposed rule, “closely related person” would mean “a natural person (including the estate and estate planning vehicles of such person) who has a longstanding business or personal relationship with any family customer.”

¹⁵⁴ See *e.g.*, ABA; BPI; IAA; and SIFMA. These commenters stated that many family wealth management vehicles rely on the exclusions provided by sections 3(c)(1) or 3(c)(7) of the Investment Company Act and would therefore be covered funds unless they satisfy the conditions for one of the 2013 rule’s exclusions from the covered fund definition.

partnerships, and other pooled investment vehicles.¹⁵⁵ Commenters further stated that absent an exclusion from the covered fund definition, family wealth management vehicles could be restricted from obtaining various types of ordinary course banking and asset management services from a banking entity simply because they would receive those services through a family wealth management vehicle.¹⁵⁶ Commenters provided examples of these services, including investment advice, brokerage execution, financing, and clearance and settlement services.¹⁵⁷ A commenter also stated that family wealth management vehicles structured as trusts for the benefit of family members also often appoint banking entities, acting in a fiduciary capacity, as trustees for the trusts.¹⁵⁸

In the 2018 proposal, the agencies requested comment regarding whether the agencies should address the application of Super 23A in the context of family wealth management vehicles. One commenter responded that the agencies should incorporate the exemptions under Section 23A and Regulation W into the definition of “covered transaction.”¹⁵⁹ However, commenters also stated that incorporating the exemptions under Section 23A and Regulation W would still not permit banking entities to engage in the full range of transactions and services sought by family wealth management vehicles, including ordinary extensions of credit, and therefore the regulations would continue to unnecessarily impede traditional banking and asset management services.¹⁶⁰ Commenters further stated that incorporation of the exemptions would

¹⁵⁵ See e.g., IAA and SIFMA.

¹⁵⁶ See e.g., BPI; IAA; and SIFMA.

¹⁵⁷ See e.g., BPI and SIFMA.

¹⁵⁸ See SIFMA.

¹⁵⁹ See *id.*

¹⁶⁰ See e.g., BPI and SIFMA.

not eliminate the uncertainty and the associated burden for banking entities resulting from an analysis of the status of a family wealth management vehicle as a covered fund. The proposal is intended to allow banking entities to provide the full range of traditional customer-facing banking and asset management services to family wealth management vehicles and recognizes that a specific exclusion for family wealth management vehicles—rather than merely addressing the application of Super 23A—is necessary to address the issues related family wealth management vehicles more completely and effectively.

Similar to the customer facilitation vehicles discussed below, the agencies believe that the proposed exclusion for family wealth management vehicles would appropriately allow banking entities to structure services or transactions for customers, or to otherwise provide traditional customer-facing banking and asset management services, through a vehicle, even though such a vehicle may rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act or would otherwise be a covered fund under the implementing regulations. The agencies have previously indicated their intent to avoid unintended results that might follow from a definition of “covered fund” that is inappropriately imprecise,¹⁶¹ and believe that these commenters have identified such unintended results. The agencies believe that an exclusion for family wealth management vehicles would effectively tailor the definition of covered fund by permitting banking entities to continue to provide traditional banking and asset management services that do not involve the types of risks section 13 was designed to address. As the agencies noted in the preamble to the 2013 rule, section 13 and the implementing regulations were designed to permit banking entities to continue to provide client-oriented financial services, including asset

¹⁶¹ See 83 FR 33471; 79 FR 5670–71.

management services.¹⁶² In addition, the agencies believe that an exclusion for family wealth management vehicles is consistent with section 13(d)(1)(D), which permits banking entities to engage in transactions on behalf of customers, when those transactions would otherwise be prohibited under section 13. The proposed exclusion would similarly allow banking entities to provide traditional services to customers through vehicles used to manage the wealth and other assets of those customers and their families.

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: (1) if the entity is a trust, the grantor(s) of the entity are all family customers and, (2) 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 3 closely related persons of the family customers. Under the proposed exclusion, a family customer would mean a family client, as defined in Rule 202(a)(11)(G)-1(d)(4) of the Advisers Act (17 CFR 275.202(a)(11)(G)-1(d)(4)); or 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.¹⁶³

¹⁶² See 79 FR 5541 (describing the 2013 rule as “permitting banking entities to continue to provide, and to manage and limit the risks associated with providing, client-oriented financial services that are critical to capital generation for businesses of all sizes, households and individuals, and that facilitate liquid markets. These client-oriented financial services, which include underwriting, market making, and asset management services, are important to the U.S. financial markets and the participants in those markets.”).

¹⁶³ All terms defined in Rule 202(a)(11)(G)-1 of the Advisers Act (17 CFR 275.202(a)(11)(G)-1) have the same meaning in the proposed family wealth management exclusion.

In addition, a banking entity would rely on the proposed exclusion only if the banking entity (or an affiliate): (1) provides bona fide trust, fiduciary, investment advisory, or commodity trading advisory services to the entity; (2) does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such entity; (3) complies with the disclosure obligations under § __.11(a)(8), as if such entity were a covered fund¹⁶⁴; (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 requirements of §§ __.14(b) and __.15, as if such issuer were a covered fund; and (6) complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof. The agencies believe that, collectively, the conditions on the proposed exclusion should help to ensure that family wealth management vehicles are used for customer oriented financial services provided on arms-length, market terms, and to prevent evasion of the requirements of section 13 of the BHC Act and the implementing

¹⁶⁴ The obligations under § __.11(a)(8) of the proposed rule would apply in connection with the exemption for organizing and offering covered funds, which would typically require the preparation and distribution of offering documents. The agencies understand that offering documents may not be necessary in connection with most family wealth management vehicles given the vehicles' purpose and the requirement that interests in such vehicles be limited to family customers and up to 3 closely related persons of the family customers. Accordingly, the agencies believe that for purposes of the proposed exclusion, a banking entity could satisfy these written disclosure obligations in a number of ways, such as including them in the family wealth management vehicle's governing documents, in account opening materials or in supplementary materials. The condition reflects the agencies' interest in providing family customers with the substance of the disclosures, rather than a concern with the document in which they are provided. Similarly, the agencies expect the specific wording of the disclosures in § __.11(a)(8) of the proposed rule may need to be modified to accurately reflect the specific circumstances of the family wealth management vehicle.

regulations. In addition, these proposed conditions are based on existing conditions in other provisions of the implementing regulations,¹⁶⁵ which the agencies believe should facilitate banking entities' compliance.

The agencies are not proposing to apply Super 23A to family wealth management vehicles because, as discussed above, the agencies understand that the application of Super 23A to family wealth management vehicles would prohibit banking entities from providing the full range of banking and asset management services to customers using these vehicles. However, the agencies are proposing to apply the prohibition on purchases of low-quality assets under the Board's regulations implementing section 23A of the Federal Reserve Act (12 CFR 223.15(a)) to help ensure that the exclusion for family wealth management vehicles does not allow banking entities to "bail out" the vehicle.

The agencies believe that the proposed definition of a family wealth management vehicle appropriately distinguishes it from the type of entity that section 13 of the BHC Act intended to capture. The proposed definition would require that a family wealth management vehicle not raise money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities. This aspect of the definition would help to differentiate family wealth management vehicles from covered funds, which raise money from

¹⁶⁵ See implementing regulations § __.11(a)(5) (imposing, as a condition of the exemption for organizing and offering a covered fund, that a banking entity and its affiliates do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests); § __.11(a)(8) (imposing, as a condition of the exemption for organizing and offering a covered fund, that the banking entity provide certain disclosures to any prospective and actual investor in the covered fund); § __.10(c)(2)(ii) (allowing, as a condition of the exclusion from the covered fund definition for wholly-owned subsidiaries, for the holding of up to 0.5 percent of outstanding ownership interests by a third party for limited purposes); and § __.14(b) (subjecting certain transactions with covered funds to section 23B of the Federal Reserve Act).

investors for this purpose. Defining “family customer” by building off of the definition of “family client” from rule 202(a)(11)(G)-1(d)(4) of Advisers Act (family office rule) may facilitate compliance by using a definition known in the financial services industry. At the same time, the agencies recognize that the purpose of the family wealth management exclusion differs from the purpose of the family office rule, and should be designed to capture the types of persons and entities to which banking entities have traditionally provided banking and asset management services, as these services do not expose banking entities to the types of risks that section 13 was intended to restrict and would facilitate banking entities’ customer-facing financial services. Accordingly, the agencies believe it appropriate to include as “family customers” certain in-laws of the family clients as well as a limited number of persons closely related to the family customers.

Question 53. Should the agencies exclude family wealth management vehicles from the definition of “covered fund” as proposed? Does the agencies’ proposed definition of “family wealth management vehicle” include the appropriate vehicles? What, if any, modifications to the scope, definitions or conditions prescribed in the proposed exclusion should be made? Should the agencies provide any additional guidance or requirements regarding the conditions? For example, should the agencies provide additional guidance or requirements regarding the timing of the disclosures required by § __.11(a)(8)?

Question 54. Would an exclusion for family wealth management vehicles create any opportunities for evasion, for example, by allowing a banking entity to structure investment vehicles to evade the restrictions of section 13 on covered fund activities? Why or why not? If so, how could such concerns be addressed? Please explain.

Question 55. Are there alternative approaches the agencies should take to enable banking entities to provide family wealth management vehicles with banking and asset management services?

Question 56. The proposed exclusion would require the banking entity and its affiliates to comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof. Should the agencies adopt this proposed requirement? Why or why not? Would this proposed requirement address the agencies' concerns about banking entities or their affiliates bailing out a family wealth management vehicle? Why or why not?

Question 57. The proposed exclusion permits ownership of the family wealth management vehicle by 3 closely related persons of the family customer owners. Should the exclusion permit closely related persons to invest in family wealth management vehicles? What, if any, modifications should the agencies make to the proposed definition of "closely related person"? Why or why not? For example, should the definition of "closely related person" include individuals with longstanding personal relationships with family customers, but exclude individuals with only longstanding business relationships with family customers, or vice versa? Should the number of closely related persons permitted to invest in the family wealth management vehicle be increased, decreased, or remain at 3 such persons? Should, for example, the agencies consider raising the number of closely related persons to 10 to parallel the number of permitted unaffiliated co-venturers permitted under the § __.10(c) exclusion for joint ventures? Why or why not? What if any other or additional qualitative or quantitative limits on the ownership interest of closely related persons in family wealth management vehicles? Would the inclusion of closely related persons that are not family customers in the family wealth

management vehicle exclusion raise concerns about these vehicles being used to evade the prohibitions in section 13 of the BHC Act? Why or why not? Commenters should offer specific examples detailing when it would be appropriate for a family wealth management vehicle to include persons that are not family customers.

Question 58. The proposed family wealth management vehicle exclusion would permit a banking entity or its affiliates to hold up to 0.5 percent of the issuer's outstanding ownership interests only to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns. Instead of permitting such an ownership interest to be held by a banking entity or its affiliates, should the agencies permit such an ownership interest to be held by a third party that is unaffiliated with either the banking entity or the family customer? Why or why not?

Question 59. The proposed family wealth management vehicle exclusion would require the banking entity and its affiliates to comply with the requirements of § __.14(b) and § __.15, as if the family wealth management vehicle were a covered fund. Should the exclusion require also that the banking entity and its affiliates comply with the requirements of all of § __.14? Why or why not?

4. Customer Facilitation

The agencies are proposing to exclude from the definition of "covered fund" under § __.10(b) of the rule any issuer that acts as a "customer facilitation vehicle." The proposed customer facilitation vehicle 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. In response to the 2018

proposal, a number of commenters indicated that the 2013 rule has restricted their ability to provide banking and asset management services to customers and requested an exclusion for vehicles or structures created to accommodate customer exposure to securities, transactions, or other services that banking entities can provide directly to the customers.¹⁶⁶ Commenters provided examples of services or transactions that customers (or a group of affiliated customers) might prefer to receive from a banking entity through a vehicle formed to facilitate those services or transactions rather than directly. For example, a customer might wish to purchase structured notes issued by a vehicle rather than a banking entity for certain legal, counterparty risk management, or accounting reasons specific to the customer.¹⁶⁷ Similarly, a customer might seek financing or exposure to a particular, customer-specified investment through a special purpose vehicle to structure the transaction for the customer's business needs or objectives.¹⁶⁸ Another commenter stated that many clients, in particular non-U.S. clients, prefer to face an entity structure rather than a banking entity to facilitate their trading and lending transactions for a variety of legal, counterparty risk management and accounting reasons.¹⁶⁹

The agencies believe that the proposed exclusion for customer facilitation vehicles would appropriately allow banking entities to structure these types of services or transactions for customers, or to otherwise provide traditional customer-facing banking and asset management services, through a vehicle, even though such a vehicle may rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act or would otherwise be a covered fund under the implementing regulations. While neither section 13 nor the implementing regulations would restrict a banking

¹⁶⁶ See SIFMA; FSF; and ABA.

¹⁶⁷ See SIFMA and FSF.

¹⁶⁸ See ABA.

¹⁶⁹ See BPI.

entity from providing these services to a customer directly, commenters have indicated that the broad definition of “covered fund” in the 2013 rule has prevented or otherwise impeded banking entities from providing such services to a customer through vehicles owned or formed by that customer. The agencies have previously indicated their intent to avoid unintended results that might follow from a definition of “covered fund” that is inappropriately imprecise,¹⁷⁰ and believe that these commenters have identified such unintended results. In particular, the agencies do not believe that section 13 was intended to interfere unnecessarily with the ability of banking entities to provide services to their customers simply because the customer may prefer to receive those services through a vehicle or through a transaction with a vehicle instead of directly with the banking entity. As the agencies noted in the preamble of the 2013 rule, section 13 and the implementing regulations were designed to permit banking entities to continue to provide client-oriented financial services, which the agencies believe would include asset management services provided through customer facilitation vehicles.¹⁷¹

The agencies have previously indicated that section 13 permits the agencies to tailor the scope of the definition of covered fund to funds that engage in the investment activities contemplated by section 13 (as opposed, for example, to vehicles that merely serve to facilitate corporate structures).¹⁷² In addition, the agencies believe that an exclusion for customer

¹⁷⁰ See 83 FR 33471; 79 FR 5670-71.

¹⁷¹ See 79 FR 5541 (describing the 2013 rule as “permitting banking entities to continue to provide, and to manage and limit the risks associated with providing, client-oriented financial services that are critical to capital generation for businesses of all sizes, households and individuals, and that facilitate liquid markets. These client-oriented financial services, which include underwriting, market making, and asset management services, are important to the U.S. financial markets and the participants in those markets.”).

¹⁷² See 83 FR 33471 (citing 79 FR 5666).

facilitation vehicles is consistent with section 13(d)(1)(D), which permits banking entities to engage in transactions on behalf of customers, when those transactions would otherwise be prohibited under section 13. The agencies have elsewhere tailored the 2013 rule to allow banking entities to meet their customers' needs.¹⁷³ The proposed exclusion would similarly allow banking entities to provide customer-oriented financial services through a vehicle when that vehicle's purpose is to facilitate a customer's exposure to those services.¹⁷⁴ The agencies believe that these vehicles do not expose banking entities to the types of risks that section 13 was intended to restrict and would facilitate banking entities' customer-facing financial services.

The proposed exclusion would require that the vehicle be formed by or at the request of the customer. This requirement is intended to help ensure that customer facilitation vehicles are formed to provide customer-oriented financial services, and to differentiate customer facilitation vehicles from covered funds that are organized and offered by the banking entity. This condition would not preclude a banking entity from marketing its services through the use of customer

¹⁷³ For example, the agencies in 2019 amended the exemption for risk-mitigating hedging activities to allow banking entities to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund. *See* 2019 amendments § __.13(a)(1)(ii). *See also* 2019 amendments § __.3(d)(11) (excluding from the definition of "proprietary trading" the entering into of customer-driven swaps or customer-driven security-based swaps and matched swaps or security-based swaps under certain conditions).

¹⁷⁴ The proposed exclusion would not require that the customer relationship be pre-existing. That is, the proposed exclusion could be available for an issuer that is formed for the purpose of facilitating the exposure of a customer of the banking entity where the customer relationship begins only in connection with the formation of that issuer. The agencies took a similar approach to this question in describing the exemption for activities related to organizing and offering a covered fund under § __.11(a) of the 2013 rule. *See* 79 FR 5716. The agencies indicated that section 13(d)(1)(G), under which the exemption under § __.11(a) was adopted, did not explicitly require that the customer relationship be pre-existing. Similarly, section 13(d)(1)(D) does not explicitly require a pre-existing customer relationship.

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.

A banking entity would be able to rely on the customer facilitation vehicle exclusion only under certain conditions, including that all of the ownership interests of the issuer are owned by the customer (which may include one or more of the customer's affiliates) for whom the issuer was created, other than a *de minimis* interest that may be held by the banking entity or its affiliates for specified purposes (as described below). The agencies believe that this condition would be appropriate to prevent banking entities from using the proposed exclusion for customer facilitation vehicles to evade the restrictions of section 13. A banking entity and its affiliates would have to maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to such transaction, investment strategy, or service. The agencies believe that this condition would support their ability to examine for, and make assessments regarding, compliance with the proposed exclusion.

Additional conditions for the customer facilitation vehicle exclusion would include that the banking entity and its affiliates: (1) do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such issuer; (2) comply with the disclosure obligations under § __.11(a)(8), as if such issuer were a covered fund;¹⁷⁵ (3) do not acquire or

¹⁷⁵ The obligations under § __.11(a)(8) apply in connection with the exemption for organizing and offering covered funds, which would typically require the preparation and distribution of offering documents. The agencies understand that offering documents may not be necessary in connection with most customer facilitation vehicles given the vehicles' purpose and the requirement that interests in such vehicles will be limited to a banking entity's customer or group of affiliated customers. Accordingly, the agencies believe that for purposes of the proposed exclusion, a banking entity could satisfy these written disclosure obligations in a number of ways, such as including them in the customer facilitation vehicle's governing documents, in account opening materials, or in supplementary materials. The condition reflects the agencies' interest in providing customers with the substance of the disclosures, rather than a concern with

retain, as principal, an ownership interest in the issuer, other than up to 0.5 percent of the issuer'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; (4) comply with the requirements of § __.14(b) and § __.15, as if such issuer were a covered fund; and (5) comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof.

The agencies believe that, collectively, the conditions on the proposed exclusion should help to ensure that customer facilitation vehicles would be used for customer-oriented financial services provided on arms-length, market terms, and should help to prevent evasion of the requirements of section 13 and the implementing regulations. The agencies also believe that the conditions would be consistent with the purposes of section 13. In addition, these proposed conditions are based on existing conditions in other provisions of the implementing regulations,¹⁷⁶ which the agencies believe should facilitate banking entities' compliance.

The agencies are not proposing to apply Super 23A to customer facilitation vehicles because the agencies understand that the application of Super 23A to customer facilitation

the document in which they are provided. Similarly, the agencies expect that the specific wording of the disclosures under § __.11(a)(8) may need to be modified to reflect accurately the specific circumstances of the customer facilitation vehicle.

¹⁷⁶ See implementing regulations § __.11(a)(5) (imposing, as a condition of the exemption for organizing and offering a covered fund, that a banking entity and its affiliates do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests); § __.11(a)(8) (imposing, as a condition of the exemption for organizing and offering a covered fund, that the banking entity provide certain disclosures to any prospective and actual investor in the covered fund); § __.10(c)(2)(ii) (allowing, as a condition of the exclusion from the covered fund definition for wholly-owned subsidiaries, for the holding of up to 0.5 percent of outstanding ownership interests by a third party for limited purposes); and § __.14(b) (subjecting certain transactions with covered funds to section 23B of the Federal Reserve Act).

vehicles would prohibit banking entities from providing the full range of banking and asset management services to customers using these vehicles. However, the agencies are proposing to apply the prohibition on purchases of low-quality assets under the Board's regulations implementing section 23A of the Federal Reserve Act (12 CFR 223.15(a)) to help ensure that the exclusion for customer facilitation vehicles does not allow banking entities to "bail out" the vehicle.

Question 60. Is the proposed exclusion for customer facilitation vehicles appropriate? Why or why not?

Question 61. Does the proposed exclusion for customer facilitation vehicles include the appropriate vehicles? Why or why not? If not, how should the agencies expand or narrow the vehicles for which banking entities would be permitted to make use of the exclusion? What modifications to the proposed exclusion would be appropriate and why?

Question 62. Are the proposed conditions on the proposed exclusion for customer facilitation vehicles appropriate? Why or why not? If not appropriate, how should the agencies modify the conditions, and why?

Question 63. Should the agencies require, as a condition for satisfying the proposed exclusion, that the customer facilitation vehicle be formed at the request of the customer? Why or why not?

Question 64. Should the agencies specify to which types of transaction, investment strategy, or other service such a customer facilitation vehicle could be formed to facilitate exposure? Why or why not?

Question 65. The proposed exclusion would permit a banking entity or its affiliates to hold up to 0.5 percent of the issuer's outstanding ownership interests only to the extent necessary

for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns. Instead of permitting such an ownership interest to be held by a banking entity or its affiliates, should the agencies permit such an ownership interest to be held by a third party that is unaffiliated with either the banking entity or the customer? Why or why not?

Question 66. The proposed exclusion would require the banking entity and its affiliates to comply with the requirements of § __.14(b) and § __.15, as if the customer facilitation vehicle were a covered fund. Should the exclusion require also that the banking entity and its affiliates comply with the requirements of all of § __.14? Why or why not?

Question 67. The proposed exclusion would require the banking entity and its affiliates to comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof. Should the agencies adopt this proposed requirement? Why or why not? Would this proposed requirement address the agencies' concerns about banking entities or their affiliates bailing out a customer facilitation vehicle? Why or why not?

Question 68. Would the proposed exclusion for customer facilitation vehicles create any opportunities for evasion, for example, by allowing a banking entity to structure such vehicles in a manner to evade the restrictions of section 13 on covered fund activities? Why or why not? If so, what conditions could be imposed to address such concerns? For example, should the agencies impose a restriction that a customer facilitation vehicle only be able to serve customers who initiate or request a given transaction, investment strategy, or other service? Do the conditions that would be imposed on the proposed exclusion address those concerns? Please explain.

Question 69. Should the agencies take a different approach to enable banking entities to provide customers with exposure to a transaction, investment strategy, or other service provided by the banking entity? For example, would modifications to § __.14 of the implementing regulations, whether as proposed below or otherwise, allow banking entities to provide customers with this exposure? Please explain.

Question 70. For banking entities with significant trading assets and liabilities that sponsor funds relying on the proposed exclusion for customer facilitation vehicles, would it be appropriate to require additional documentation requirements pursuant to § __.20(e)(2) consistent with other sponsored funds relying on certain exclusions from the definition of covered fund? Why or why not? Similarly, should the documentation requirements of § __.20(e)(2) also be applied to sponsored funds relying on the other new proposed exclusions for credit funds, venture capital funds, and family wealth management vehicles? Why or why not?

D. Limitations on Relationships with a Covered Fund

The agencies are proposing to modify the regulations implementing section 13(f)(1) of the BHC Act to permit banking entities to engage in a limited set of covered transactions with covered funds for which the banking entity directly or indirectly serves as investment manager, investment adviser, or sponsor, or that the banking entity organizes and offers pursuant to section 13(d)(1)(G) of the BHC Act (such funds, related covered funds). Specifically, as described below, the proposal would allow a banking entity to enter into covered transactions with a related covered fund that would be permissible without limit for a state member bank to enter into with an affiliate under section 23A of the Federal Reserve Act. This would include, for example, intraday extensions of credit. The proposal would also allow a banking entity to enter into short-term extensions of credit with, and purchase assets from, a related covered fund in connection

with payment, clearing, and settlement activities. These proposed amendments would address certain concerns raised by regulated banking entities and commenters with respect to the impact of section 13(f)(1) on the practical ability of banking entities to organize and offer covered funds as permitted by section 13(d)(1)(G).

Section 13(f)(1) of the BHC Act generally prohibits a banking entity from entering into a transaction with a related covered fund that would be a covered transaction as defined in section 23A of the Federal Reserve Act.¹⁷⁷

Section 23A of the Federal Reserve Act limits the aggregate amount of covered transactions by a member bank to no more than (1) 10 percent of the capital stock and surplus of the member bank in the case of any one affiliate, and (2) 20 percent of the capital stock and surplus of the member bank in the aggregate with respect to all affiliates.¹⁷⁸ By contrast, section

¹⁷⁷ 12 U.S.C. 1851(f)(1); *see* 12 U.S.C. 371c. Section 13(f)(3) of the BHC Act also provides an exemption for prime brokerage transactions between a banking entity and a covered fund in which a covered fund managed, sponsored, or advised by that banking entity has taken an ownership interest. 12 U.S.C. 1851(f)(3). In addition, section 13(f)(2) subjects any transaction permitted under section 13(f) (including a permitted prime brokerage transaction) between a banking entity and covered fund to section 23B of the Federal Reserve Act. 12 U.S.C. 1851(f)(2); *see* 12 U.S.C. 371c–1.

¹⁷⁸ 12 U.S.C. 371c. The term “covered transaction” is defined in section 23A of the Federal Reserve Act to mean, with respect to an affiliate of a member bank, (1) a loan or extension of credit to the affiliate, including a purchase of assets subject to an agreement to repurchase; (2) a purchase of or an investment in securities issued by the affiliate; (3) a purchase of assets from the affiliate, except such purchase of real and personal property as may be specifically exempted by the Board by order or regulation; (4) the acceptance of securities or other debt obligations issued by the affiliate as collateral security for a loan or extension of credit to any person or company; (5) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate; (6) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate; or (7) a derivative transaction, as defined in paragraph (3) of section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b)), with an affiliate, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate. *See* 12 U.S.C. 371c(b)(7), as amended by Pub. L. 111.203, section 608 (July 21, 2010). Section 13(f) of the BHC Act does not alter the applicability of

13(f)(1) of the BHC Act generally prohibits covered transactions between a banking entity and a related covered fund, with no minimum amount of permissible covered transactions.¹⁷⁹ Despite this general prohibition, another part of section 13 authorizes a banking entity to own an interest in a related covered fund, which would be a “covered transaction” for purposes of section 23A of the Federal Reserve Act.¹⁸⁰ In addition to this apparent conflict between paragraphs 13(d) and (f) with respect to covered fund ownership, there are other elements of these paragraphs that introduce ambiguity about the interpretation of the term “covered transaction” as used in section 13(f) of the BHC Act. The statute prohibits a banking entity that organizes or offers a hedge fund or private equity fund from directly or indirectly guaranteeing, assuming, or otherwise insuring the obligations or performance of the fund (or of any hedge fund or private equity fund in which such hedge fund or private equity fund invests).¹⁸¹ To the extent that section 13(f) prohibits all covered transactions between a banking entity and a related covered fund, however, the independent prohibition on guarantees in section 13(d)(1)(G)(v) would seem to be unnecessary and redundant.¹⁸²

The agencies addressed the apparent conflict between section 13(f)(1) and particular provisions in section 13(d)(1) of the BHC Act in the 2013 rule by interpreting the statutory language to permit a banking entity “to acquire or retain an ownership interest in a covered fund

section 23A of the Federal Reserve Act and the Board’s Regulation W to covered transactions between insured depository institutions and their affiliates.

¹⁷⁹ 12 U.S.C. 1851(f)(1).

¹⁸⁰ 12 U.S.C. 1851(d)(1)(G); (d)(4).

¹⁸¹ 12 U.S.C. 1851(d)(1)(G)(v).

¹⁸² *See* 12 U.S.C. 371c(b)(7)(E); 12 CFR 223.3(h)(4).

in accordance with the requirements of section 13.”¹⁸³ In doing so, the agencies noted that a contrary interpretation would make the specific language that permits covered transactions between a banking entity and a related covered fund “mere surplusage.”¹⁸⁴

In adopting the regulations to reconcile the conflict between paragraphs (d) and (f) of section 13 of the BHC Act, the agencies did not use their rulemaking authority pursuant to section (d)(1)(J).¹⁸⁵ Instead, the agencies used their general rulemaking authority to interpret section 13 of the BHC Act. Although the agencies previously expressed doubt about their ability to permit banking entities to enter into covered transactions with related covered funds pursuant to their authority under section 13(d)(1)(J) of the BHC Act,¹⁸⁶ the activities permitted pursuant to paragraph (d) specifically contemplate allowing a banking entity to enter into certain covered transactions with related funds.¹⁸⁷ The exceptions in section 13(f)(1) are also expressly incorporated into the statutory list of permitted activities, specifically in section 13(d)(1)(G)(iv).¹⁸⁸ By virtue of the conflict between paragraphs (d) and (f) of section 13, and the inclusion of specific covered transactions within the permitted activities in paragraph (d) of section 13, the agencies believe that the authority granted pursuant to paragraph (d)(1)(J) to determine that other activities are not prohibited by the statute authorizes the agencies to exercise rulemaking authority to determine that banking entities may enter into covered transactions with

¹⁸³ 79 FR 5746.

¹⁸⁴ 79 FR 5746.

¹⁸⁵ *Id.*

¹⁸⁶ *See* 76 FR 68912 n.313.

¹⁸⁷ 12 U.S.C. 1851(d)(1)(G); (d)(4).

¹⁸⁸ 12 U.S.C. 1851(d)(1)(G)(iv).

related covered funds that would otherwise be prohibited by section 13(f)(1) of the BHC Act, provided that the rulemaking complies with applicable statutory requirements.¹⁸⁹

In the 2018 proposal, the agencies invited comment from the public on the agencies' 2013 interpretation of section 13(f)(1) of the BHC Act,¹⁹⁰ and whether that interpretation should be amended.¹⁹¹ Among other things, the agencies invited comment on whether to incorporate some or all of the exemptions or quantitative limits in section 23A of the Federal Reserve Act and the Board's Regulation W, and if so, whether these transactions should be subject to any additional limitations.¹⁹² However, the agencies did not propose specific amendments addressing the interpretation of section 13(f)(1) of the BHC Act.¹⁹³

Several commenters addressed the interpretation of section 13(f)(1) of the BHC Act, and the specific questions asked by the agencies. Several commenters recommended that the agencies interpret section 13(f)(1) to include the exemptions provided under section 23A of the Federal Reserve Act.¹⁹⁴ Some commenters also encouraged the agencies to permit banking entities to engage in a quantitatively limited amount of covered transactions with related covered

¹⁸⁹ 12 U.S.C. 1851(b)(2), (d)(1)(J), (d)(2).

¹⁹⁰ In the preamble to the 2013 rule, the agencies noted that “[s]ection 13(f) of the BHC Act does not incorporate or reference the exemptions contained in section 23A of the FR Act or the Board's Regulation W.” 79 FR 5746.

¹⁹¹ 83 FR 33486-487.

¹⁹² *Id.* at 33487.

¹⁹³ On March 29, 2017, the CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) issued a letter to a futures commission merchant (FCM) stating that the DSIO would not recommend that an enforcement action against the FCM be initiated in connection with § __.14(a) of the 2013 rule. Although no specific amendments were provided in the 2018 proposal, the proposal would permit FCMs that are banking entities to enter into certain covered transactions with covered funds in connection with futures, options and swaps clearing services to covered funds pursuant to § __.14(a).

¹⁹⁴ *See, e.g.*, ABA; BPI; and FSF.

funds.¹⁹⁵ Conversely, one commenter opposed revising the regulations to incorporate the Federal Reserve Act's section 23A exemptions or quantitative limits.¹⁹⁶

Banking entities that sponsor or serve as the investment adviser to covered funds and groups representing such banking entities have argued that the inability to engage in any covered transactions with such funds, particularly those types of transactions that are expressly exempted under section 23A of the Federal Reserve Act and the Board's Regulation W, has limited the services that they or their affiliates can provide.¹⁹⁷ Some of these commenters have argued that amending the regulations to permit limited covered transactions with related covered funds would not create any new incentives for the banking entity to financially support the related covered fund in times of stress and would not otherwise permit the banking entity to indirectly engage in proprietary trading through the related covered fund.¹⁹⁸ For example, when a banking entity that sponsors or advises a covered fund also serves as a broker-dealer to the covered fund, the prohibition on covered transactions between the banking entity (and its affiliates) and the covered fund may limit the ability of the banking entity and its affiliates to provide other services, such as trade settlement services, to the covered fund. A broker-dealer providing trade settlement services may extend intraday credit to the fund, or purchase assets from the fund, in connection with trading activities in the ordinary course of business. One group representing banking entities also noted that extensions of credit in connection with payment, clearing, and settlement services that were intended to be intraday may become overnight extensions of credit,

¹⁹⁵ *See, e.g.*, BPI and FSF.

¹⁹⁶ *See* Public Citizen.

¹⁹⁷ *See, e.g.*, BPI; CS; and IAA.

¹⁹⁸ *Id.*

for example due to time zone differences in local settlement markets.¹⁹⁹ Under the interpretation provided in the preamble to the 2013 rule,²⁰⁰ both intraday extensions of credit and overnight extensions of credit are “covered transactions” for purposes of section 13(f)(1) of the BHC Act, and therefore would be impermissible for a banking entity with respect to a related covered fund.

The agencies believe that, under certain circumstances, it would be appropriate to permit banking entities to enter into certain covered transactions with related covered funds, and therefore are proposing to amend §__.14 of the implementing regulations as described below. The proposed amendments would not modify the definition of “covered transaction” but instead would authorize banking entities to engage in limited activities with related covered funds. Any transactions or activities permitted by these revisions would be required to comply with certain conflict of interest, high-risk, and safety and soundness restrictions.

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 section 223.42 of the Board’s Regulation W.²⁰¹ Section 23A of the Federal Reserve Act is designed to protect against a depository institution suffering losses in transactions with affiliates, and to limit the ability of a depository institution

¹⁹⁹ See, e.g., SIFMA.

²⁰⁰ See 79 FR 5746.

²⁰¹ See 12 U.S.C. 371c(d); 12 CFR 223.42.

to transfer to its affiliates the “subsidy” arising from the depository institution’s access to the Federal safety net.²⁰²

Notwithstanding the statutory objectives of section 23A of the Federal Reserve Act, however, a member bank may enter into certain “exempt” covered transactions set forth in section 23A of the Federal Reserve Act and the Board’s Regulation W, without regard to the quantitative limits, collateral requirements, and low-quality asset prohibition of section 23A and the Board’s Regulation W.²⁰³ These exempt transactions do not raise the same concerns that they could cause the depository institution to suffer losses or transfer the subsidy arising from the depository institution’s access to the Federal safety net. The agencies believe that the same rationales that support the exemptions in section 23A of the Federal Reserve Act and the Board’s Regulation W also support exempting such transactions from the prohibition on covered transactions between a banking entity and related covered funds under section 13(f)(1) of the BHC Act. In particular, the agencies note that these exemptions generally do not present significant risks of loss, and serve important public policy objectives.²⁰⁴

²⁰² For a brief background on section 23A of the Federal Reserve Act, see Transactions Between Member Banks and Their Affiliates, 67 FR 76560-765561 (December 12, 2002).

²⁰³ See 12 U.S.C. 371c(d); 12 CFR 223.42.

²⁰⁴ For example, intraday extensions of credit are exempt covered transactions under section 23A of the Federal Reserve Act. The Board previously has noted that “[i]ntraday overdrafts and other forms of intraday credit generally are not used as a means of funding or otherwise providing financial support for an affiliate. Rather, these credit extensions typically facilitate the settlement of transactions between an affiliate and its customers when there are mismatches between the timing of funds sent and received during the business day.” 67 FR 76596.

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

In addition, 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 appropriate limits. First, 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. Second, each extension of credit would be required to be repaid, sold, or terminated no later than five business days after it was originated. The provision of payment, clearing, and settlement services by a banking entity (or its affiliates) to an affiliated covered fund generally requires the ability to provide such short-term extensions of credit, and therefore is a necessary corollary to the exempt covered transactions that would allow banking entities to provide standard payment, clearing, and settlement services to related covered funds. Additionally, the proposed five business day criterion would be consistent with the Federal banking agencies' capital rule and would generally require banking entities to rely on transactions with normal settlement periods, which have lower risk of delayed settlement or failure, when providing short-term extensions of credit.²⁰⁵ Each short-term extension of credit must also meet the same requirements applicable to intraday extensions of credit under section 223.42(l)(1)(i) and (ii) of the Board's Regulation W (as if the extension of credit was an intraday

²⁰⁵ See 78 FR 62110 (October 11, 2013). While the Federal banking agencies require firms to track and monitor the credit risk exposure for transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement, this requirement does not apply to other types of transactions which may be used in providing a short-term extension of credit (e.g., repo-style transactions). Additionally, banking entities typically monitor credit extensions by counterparty, and not by transaction type. Thus, the proposal would remain consistent with the approach taken in the Federal banking agencies' capital rule, without imposing an additional compliance burden without a corresponding benefit.

extension of credit, regardless of the duration of the extension of credit). In addition, each extension of credit or purchase of assets permitted by these revisions would be required to comply with certain conflict of interest, high-risk, and safety and soundness restrictions.

Impact of the Proposed Amendments on Safety and Soundness and U.S. Financial Stability

The agencies expect that the proposed amendments described above would generally promote and protect the safety and soundness of banking entities and U.S. financial stability.

First, allowing banking entities to engage in these limited covered transactions with related covered funds may allow banking entities to reduce operational risk. Currently, the restrictions under section 13(f)(1) of the BHC Act substantially limit the ability of a banking entity to both (1) organize and offer a covered fund, or act as an investment adviser to the covered fund, and (2) provide custody or other services to the fund. As a result, a third party is required to provide other necessary services for the fund's operation, including payment, clearing, and settlement services that are generally provided by the fund's custodian. This increases the potential for problems at the third-party service provider (e.g., an operational failure or a disruption to normal functioning) to affect the banking entity or the fund, which were required to use the third-party service provider as a result of the restrictions under section 13(f)(1). Those problems may then spread among financial institutions or markets and thereby threaten the stability of the U.S. financial system. By amending § __.14(a), therefore, the proposal may allow a banking entity to reduce both operational risk and interconnectedness to other financial institutions by directly providing a broader array of services to a fund it organizes

and offers, or advises. The agencies believe that reducing these risks could promote and protect the safety and soundness of banking entities.²⁰⁶

Second, the proposed amendments may promote and protect U.S. financial stability by reducing interconnectedness among firms. As described above, the authorized covered transactions would permit banking entities to provide a more comprehensive suite of services to related covered funds, reducing the need to rely on third parties to provide such services.

This proposal would remain subject to additional limitations on transactions with related covered funds. As specified in the statute, such activities would be permissible only to the extent permitted by any other provision of Federal or state law, and subject to the limitations under section 13(d)(2) of the BHC Act and any restrictions or limitations that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, may determine.²⁰⁷ Section 13(d)(2) of the BHC Act also imposes additional restrictions on any activities authorized pursuant to section (d)(1), including those activities authorized by rulemaking pursuant to section (d)(1)(J).²⁰⁸

Sections __.14(b) and __.14(c) of the regulations implementing section 13 of the BHC Act both generally require that a banking entity may enter into certain transactions specified in section 23B of the Federal Reserve Act (including “covered transactions” as defined in section 23A of the Federal Reserve Act) with related covered funds only on terms and under

²⁰⁶ As noted above, the agencies also believe that the same rationales that support the exempt covered transactions in section 23A of the Federal Reserve Act and the Board’s Regulation W also support permitting a banking entity to engage in exempt covered transactions with a related covered fund.

²⁰⁷ 12 U.S.C. 1851(d)(1).

²⁰⁸ 12 U.S.C. 1851(d)(2); *see also* 2013 rule §§ __.7 and __.15.

circumstances that are substantially the same (or at least as favorable) to the banking entity as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or in the absence of comparable transactions, on terms and under circumstances that the banking entity in good faith would offer to, or would apply to, nonaffiliated companies.²⁰⁹

Question 71. What impacts would the proposed amendments to § __.14 have on the safety and soundness of banking entities, and on the financial stability of the United States? Would the activities permitted under the proposed amendments to § __.14(a) of the implementing regulations promote and protect safety and soundness of the banking entity and U.S. financial stability, and if so, how?

Question 72. Are there other services that a banking entity typically provides to sponsored funds or funds for which it acts as an investment adviser that would be prohibited under section 13(f)(1) of the BHC Act and § __.14 of the implementing regulations as proposed to be amended? What would be the impact on the safety and soundness of the banking entity, and the financial stability of the United States, of permitting a banking entity to engage in such transactions with a related covered fund?

Question 73. Should the agencies amend § __.14 of the implementing regulations to permit banking entities to engage in additional covered transactions in connection with payment, clearing, and settlement services? Why or why not? What would be the impacts of permitting banking entities to engage in payment, clearing, and settlement services with related covered funds on the safety and soundness of the banking entity? What would be the impacts of such an approach on U.S. financial stability?

²⁰⁹ 12 U.S.C. 1851(f)(2); *see* 12 U.S.C. 371c-1(a)(1).

Question 74. Should the agencies impose any additional or different qualitative or quantitative limits on the covered transactions contemplated by the proposed amendments to § __.14(a) of the implementing regulations? Why or why not? For example, should the agencies impose a quantitative limit of any kind on the covered transactions that would not be subject to the prohibition in section 13(f)(1) of the BHC Act? If the agencies were to impose a quantitative limit on such covered transactions, on what should such limits be based (e.g., based on the banking entity's tier 1 capital, the size of the fund, or some other measurement), and what limits would be appropriate?

Question 75. Is the proposed approach to addressing transactions that are exempt under Section 23A and payment, clearing, and settlement activities effective? Why or why not? Is there a better approach to addressing these types of transactions?

Question 76. The proposal would require that any payment, clearing, or settlement activity be settled within five business days. Is this length of time sufficient to effectuate the proposed permitted activities? Why or why not? Is another length of time, such as three days, more appropriate or consistent with current market practices? Should the agencies adopt a limit that adopts the shorter of five days or industry standard settlement time for a particular financial instrument?

Question 77. Should the agencies, for the purposes of § __.14(a)(2)(iv) of the proposed amendment, impose on the purchase of assets a requirement that the banking entity comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the covered fund were an affiliate thereof?

E. Ownership Interest

The agencies are proposing changes to the definition of “ownership interest” to clarify that a debt relationship with a covered fund would typically not constitute an ownership interest under the regulations.²¹⁰ In addition, the agencies are proposing amendments to the manner in which a banking entity must calculate its ownership interest for purposes of complying with the limits and conditions that apply to investments in covered funds organized and offered by a banking entity. Specifically, the proposed amendments are intended to better align the manner in which ownership limits are calculated for purposes of the quantitative limit on a banking entity’s investment in a single fund (the per fund limit), the quantitative limit on a banking entity’s investment in all covered funds (the aggregate fund limit), and the calculation of the applicable capital deductions for investments in covered funds (the covered fund deduction).²¹¹

The implementing regulations define an “ownership interest” in a covered fund to mean any equity, partnership, or other similar interest. Some banking entities have expressed concern about the inclusion of the term “other similar interest” in the definition of “ownership interest,” and have indicated that the definition of this term could lead to the inclusion of debt instruments that have standard covenants in the measurement of an ownership interest. Under the 2013 rule, “other similar interest” is defined as an interest that:

- Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a

²¹⁰ See 2013 rule § __.10(d)(6) (defining “ownership interest” for purposes of subpart C of the rule).

²¹¹ See 12 U.S.C. 1851(d)(4)(B)(ii)(I)–(II); 2013 rule §§ __.10(d)(6); __.12(a)(2)(ii)–(iii), (b)–(d).

creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

- Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;
- Has the right 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);
- Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);
- Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;
- Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or
- Any synthetic right to have, receive, or be allocated any of the rights above.²¹²

This definition focuses on the attributes of the interest and whether it provides a banking entity with economic exposure to the profits and losses of the covered fund, rather than its form. Under the 2013 rule, a debt interest in a covered fund can be an ownership interest if it has the

²¹² 2013 rule § __.10(d)(6)(i).

same characteristics as an equity or other ownership interest (e.g., provides the holder with voting rights; the right or ability to share in the covered fund's profits or losses; or the ability, directly or pursuant to a contract or synthetic interest, to earn a return based on the performance of the fund's underlying holdings or investments). The 2013 rule excludes carried interest (restricted profit interest) from the definition of ownership interest, although as discussed below, only for certain purposes.

In the 2018 proposal the agencies requested comment on all aspects of the 2013 rule's application to securitization transactions, including the definition of ownership interest. Specifically, the agencies asked whether there were any modifications that should be made to the 2013 rule's definition of ownership interest.²¹³ Among other things, the agencies requested comments on whether they should modify § __.6(i)(A) to provide that the "rights of a creditor to exercise 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.²¹⁴

In response to the 2018 proposal, a number of commenters supported the agencies' suggestion to modify § __.6(i)(A) and to expressly permit creditors 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 without causing an interest to become an ownership interest.²¹⁵ This notwithstanding, a few of these commenters noted that this modification would not address all issues with the condition as banks sometimes have

²¹³ 83 FR 33481.

²¹⁴ *Id.*

²¹⁵ *See, e.g.*, SFIG; JBA; LSTA; and IAA.

contractual rights to participate in the selection or removal of a general partner, managing member or member of the board of directors or trustees of a borrower that are not limited to the exercise of a remedy upon an event of default or other default event.²¹⁶ Therefore, these commenters proposed eliminating the “other similar interest” clause from the definition altogether or, alternatively, replacing the definition of ownership interest with the definition of “voting securities” from the Board’s Regulation Y.

A number of commenters argued that debt interests issued by covered funds and loans to third-party covered funds not advised or managed by a banking entity should be excluded from the definition of ownership interest.²¹⁷ Other commenters suggested reducing the scope of the definition of ownership interest to apply only to equity and equity-like interests that are commonly understood to indicate a bona fide ownership interest in a covered fund.²¹⁸ One other commenter asked the agencies to clarify conditions under the “other similar interest” clause.²¹⁹ Specifically, the commenter asked the agencies to clarify whether the right to receive all or a portion of the spread extends to using the spread to pay principal or the interest that is otherwise owed or to clarify that any debt repaid from collections on underlying assets of a special purpose entity, but is entitled to receive only principal and interest, is not an ownership interest. At least one commenter asked the agencies not to modify the definition of ownership interest as, the commenter argued, there is nothing under section 13 of the BHC Act that limits or restricts the

²¹⁶ See SFIG.

²¹⁷ See, e.g., Capital One et al. and BPI.

²¹⁸ See, e.g., ABA and CAE.

²¹⁹ See SFIG.

ability of a banking entity or nonbank financial company to sell or securitize loans in a manner permitted by law.²²⁰

In response to comments received and in order to provide clarity about the types of interests that would be considered within the scope of the definition of ownership interest, the agencies propose to amend the parenthetical in § __.6(i)(A) 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. Accordingly, an interest that allows its holder to remove an investment manager for cause upon the occurrence of an event of default, for example, would not be considered an ownership interest for this reason alone.

The proposed rule would also provide a safe harbor from the definition of ownership interest, as suggested by some commenters.²²¹ The safe harbor should address commenters' concerns that some ordinary debt interests could be construed as an ownership interest. 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:

- (1) 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;
- (2) The entitlement to payments on 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

²²⁰ See Data Boiler.

²²¹ See SFIG.

charge-offs of the outstanding principal balance, or reductions in the principal and interest payable; and

- (3) 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 believe that the proposed conditions for the safe harbor would provide more clarity and predictability to banking entities and enable them to determine more readily whether an interest would be an ownership interest under the regulations implementing section 13 of the BHC Act. The three conditions under the proposed safe harbor would ensure that debt interests that do not have equity-like characteristics are not considered ownership interests. At the same time, the agencies believe that the conditions are rigorous enough to prevent banking entities from evading the prohibition on acquiring or retaining an ownership interest in a covered fund.

The proposal also 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, consistent with how investments by employees and directors are treated generally under the existing rule of construction in § __.12(b)(1)(iv), the proposal would modify §§ __.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.

The 2013 rule excludes from the definition of ownership interest certain restricted profit interests.²²² As a threshold matter, the exclusion from the definition of ownership interest is limited to restricted profit interests held by an entity, employee, or former employee in a covered fund for which the entity or employee serves as investment manager, investment adviser, commodity trading advisor, or other service provider.²²³ To be excluded from the definition of ownership interest, the restricted profit interest must also meet various other conditions, including that any amounts invested in the covered fund – including amounts paid by the entity, an employee of the entity, or former employee of the entity – are within the applicable limits under § __.12 of the 2013 rule.²²⁴

Section __.12 of the 2013 rule provides different rules for purposes of calculating compliance with the per fund limit and for purposes of calculating compliance with the aggregate fund limit and covered fund deduction. Under the 2013 rule, for purposes of calculating the per fund limit and the aggregate fund limit, a banking entity is attributed ownership interests in a covered fund that are acquired by an employee or director if the banking entity, directly or indirectly, extends financing for the purpose of enabling the employee or director to acquire the ownership interest in the fund, and the financing is used to acquire such ownership interest.²²⁵ As noted in the preamble to the 2013 rule, the attribution to a banking entity of ownership

²²² 2013 rule § __.10(d)(6)(ii). As noted in the preamble to the 2013 rule, the term “restricted profit interest” was used to avoid any confusion from using the term “carried interest,” which is used in other contexts. The proposed rule would focus on the treatment of restricted profit interests for purposes of calculating compliance with the aggregate fund limit and covered fund deduction, but would not address in any way the treatment of such profit interests under other laws, including under Federal income tax law. *See* 79 FR 5706, n. 2091.

²²³ 2013 rule § __.10(d)(6)(ii).

²²⁴ 2013 rule § __.10(d)(6)(ii)(C).

²²⁵ 2013 rule § __.12(b)(1)(iv).

interests acquired by an employee or director using financing provided by the banking entity ensures that funding provided by the banking entity to acquire ownership interests in the fund, whether provided directly or indirectly, is counted against the per fund limit and aggregate fund limit.²²⁶

For purposes of calculating the aggregate fund limit and the covered fund deduction, the 2013 rule includes a different calculation with respect to restricted profit interests in a covered fund organized or offered by a banking entity pursuant to paragraph (d)(1)(G).²²⁷ Specifically, for purposes of calculating a banking entity's compliance with the aggregate fund limit and the covered fund deduction, the banking entity must include any amounts paid by the banking entity or an employee in connection with obtaining a restricted profit interest in the covered fund.²²⁸

The agencies continue to believe that it is appropriate for a banking entity to count amounts invested by the banking entity (or its affiliates) to acquire restricted profit interests in a fund organized and offered by the banking entity for purposes of the aggregate fund limit and capital deduction. However, the agencies believe attribution of employee and director ownership of restricted profit interests to a banking entity may not be necessary in the circumstance when a banking entity does not finance, directly or indirectly, the employee or director's acquisition of a restricted profit interest in a covered fund organized or offered by the banking entity. Therefore, the proposal would limit the attribution of an employee or director's restricted profit interest in a covered fund organized or offered by the banking entity to only those circumstances when the banking entity has directly or indirectly financed the acquisition of the restricted profit interest.

²²⁶ See 79 FR 5733.

²²⁷ 2013 rule § __.10(d)(6)(C); § __.12(c)(1), (d). See also 12 U.S.C. 1851(d)(1)(G).

²²⁸ *Id.*

This proposed revision would not change the treatment of the banking entity's or its affiliates' ownership of a restricted profit interest under the implementing regulations. The agencies expect that the proposed change may simplify a banking entity's compliance with the aggregate fund limit and covered fund deduction provisions of the rule, and more fully recognize that employees and directors may use their own resources, not provided by the banking entity, to invest in ownership interests or restricted profit interests in a covered fund they advise (for example, to align their personal financial interests with those of other investors in the covered fund).

Question 78. Under the proposal, 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, would be limited to removal or replacement upon the occurrence of an event of default or an acceleration event. Commenters noted in comments on the 2018 proposal that loan securitizations may include additional "for cause" termination events (e.g., the insolvency of the investment manager; the breach by the investment manager of certain representations or warranties; or the occurrence of a "key person" event or a change in control with respect to the investment manager) that might not constitute an event of default. Should the proposal 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? Why or why not?

Question 79. Under the current rule, an interest that has the right to receive a share of the income, gains or profits of the covered fund is considered an ownership interest. Should the agencies modify this condition 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? If so, why?

Question 80. Is the proposed safe harbor appropriate? Why or why not? Do the proposed conditions under the safe harbor sufficiently alleviate concerns that a senior debt instrument would not be construed as an ownership interest? If not, what amendments should be made to the proposed conditions under the safe harbor or what additional conditions should be added and why? In particular, should the reference to “fixed principal payments” under the safe harbor condition in paragraph (d)(6)(ii)(B)(1)(ii) be replaced with “contractually determined principal payments,” “*repayment of a fixed principal amount,*” or any other similar wording that may be more representative of typical principal distributions under various types of debt instruments, including asset-backed securities?

Question 81. Should the safe harbor be limited only to senior debt instruments, as proposed? Why or why not? If so, do the proposed conditions sufficiently distinguish between senior debt instruments and other debt instruments?

Question 82. Should the agencies modify the methodology of calculating a banking entity’s compliance with the aggregate fund limit and covered fund deduction in the manner proposed? Why or why not? Would the proposed revisions pose any risk that a banking entity could evade the aggregate fund limit and covered fund deduction, and if so, how? Would additional restrictions on the treatment of restricted profit interests be appropriate?

F. Parallel Investments

The 2013 rule requires that a banking entity hold no more than three percent of the total ownership interests of a covered fund that the banking entity organizes and offers pursuant to

§ __.11 of the 2013 rule.²²⁹ Section __.12(b)(1)(i) of the 2013 rule requires that, for purposes of this ownership limitation, “the amount and value of a banking entity’s permitted investment in any single covered fund shall include any ownership interest held under § __.12 directly by the banking entity, including any affiliate of the banking entity.”²³⁰ Section __.12(b) also includes several other rules of construction that address circumstances under which an investment in a covered fund would be attributed to a banking entity.

The 2011 notice of proposed rulemaking included a proposed provision that would have required attribution, under certain circumstances, of certain direct investments by a banking entity alongside, or otherwise in parallel with, a covered fund.²³¹ When adopting the 2013 rule, the agencies declined to adopt the proposed provision governing parallel investments after considering the language of the statute and commenters’ views on that provision. Commenters asserted that the provision was inconsistent with the statute, which limits investments in covered funds and not direct investments.²³² In declining to adopt this parallel investment provision, the

²²⁹ 2013 rule § __.12(a).

²³⁰ 2013 rule § __.12(b)(1)(i).

²³¹ *See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 76 FR 68846, 68951-52 (Nov. 7, 2011) (To the extent that a covered banking entity is contractually obligated to directly invest in, or is found to be acting in concert through knowing participation in a joint activity or parallel action toward a common goal of investing in, one or more investments with a covered fund that is organized and offered by the covered banking entity, whether or not pursuant to an express agreement, such investments shall be included in any calculation required under paragraph (a)(2) of this section.) (2011 proposed rule).

²³² ABA (arguing that there was no basis in the statute for any of the attribution rules proposed in the 2011 notice of proposed rulemaking, including the proposed provision regarding the treatment of an investment the banking entity is contractually obligated to invest in alongside a sponsored covered fund).

agencies noted that banking entities rely on a number of investment authorities and structures to make investments and meet the needs of their clients.²³³

The 2013 rule restricts a banking entity's investment in a covered fund organized and offered pursuant to § __.11 to three percent of the total number or value of the outstanding ownership interests of the fund.²³⁴ That regulatory requirement is consistent with section 13(d)(4) of the BHC Act, which limits the size of investments by a banking entity in a hedge fund or private equity fund.²³⁵ Neither section 13(d)(4) of the BHC Act nor the text of the 2013 rule require that a banking entity treat an otherwise permissible investment the banking entity makes alongside a covered fund as an investment in the covered fund. The text of the 2013 rule does not impose any quantitative limits on any investments by banking entities made alongside, or otherwise in parallel with, covered funds.²³⁶

However, in the preamble to the 2013 rule, the agencies went on to discuss the potential for evasion of the per fund limit and aggregate fund limit in the 2013 rule, and stated that “if a banking entity makes investments side by side in substantially the same positions as the covered fund, then the value of such investments shall be included for purposes of determining the value of the banking entity's investment in the covered fund.”²³⁷ The agencies also stated that “a banking entity that sponsors the covered fund should not itself make any additional side by side co-investment with the covered fund in a privately negotiated investment unless the value of

²³³ 79 FR 5734.

²³⁴ 2013 rule § __.12(a).

²³⁵ 12 U.S.C. 1851(d)(4).

²³⁶ Any investment by the banking entity would need to comply with the proprietary trading restrictions in Subpart B of the implementing regulations.

²³⁷ 79 FR 5734 (emphasis added).

such co-investment is less than 3% of the value of the total amount co-invested by other investors in such investment.”²³⁸

The agencies did not discuss the application of the per fund limit and aggregate fund limit in the context of a banking entity’s investments alongside a covered fund in the 2018 proposal. Nonetheless, in response to the 2018 proposal, three commenters recommended that the rule should not impose a limit on parallel investments and noted that this restriction is not reflected in the 2013 rule text.²³⁹ These commenters argued that a restriction on parallel investments interferes with banking entities’ ability to make otherwise permissible investments directly on their balance sheets. These commenters also contended that it is not necessary to restrict direct investments by a banking entity in this manner because these investments are subject to all the capital and safety and soundness requirements that apply to the banking entity.²⁴⁰ Further, two commenters asserted that such direct investments are also subject to the proprietary trading provisions of the 2013 rule.²⁴¹

In light of the comments received, the agencies are proposing to add a new rule of construction to § __.12(b) that would address investments made by banking entities alongside covered funds.²⁴² As discussed in more detail below, these provisions would clarify in the rule

²³⁸ *See id.* at 5734 *Id.*

²³⁹ FSF; Goldman; and SIFMA.

²⁴⁰ FSF; Goldman; and SIFMA.

²⁴¹ FSF and SIFMA.

²⁴² Proposed rule § __.12(b)(5). These kinds of investments could be, for example, parallel investments or co-investments. For these purposes, “parallel investments” generally refers to a series of investments that are made side-by-side with a covered fund, and “co-investments” generally refers to a specific investment opportunity that is made available to third-parties when the general partner or investment manager for the covered fund determines that the covered fund does not have sufficient capital available to make the entire investment in the target portfolio

text that banking entities are not required to treat these types of direct investments alongside a covered fund as an investment in the covered fund as long as certain conditions are met.

Specifically, proposed § __.12(b)(5) would provide that:

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

As discussed in the preamble to the 2013 rule, the agencies recognize that banking entities rely on a number of investment authorities and structures to make investments and meet the needs of their clients and shareholders.²⁴³ The proposed rule of construction would provide clarity to banking entities that they may make such investments for the benefit of their clients and shareholders, provided that those investments comply with applicable laws and regulations. Accordingly, banking entities would not be permitted to engage in prohibited proprietary trading alongside a covered fund. Moreover, banking entities would need to have authority to make any investment alongside a covered fund under applicable banking and other laws and regulations,

company or determines that it would not be suitable for the covered fund to take the entire available investment.

²⁴³ 79 FR 5734.

and would need to ensure that the investment complies with applicable safety and soundness standards. For example, national banks are restricted in their ability to make direct equity investments under 12 U.S.C. 24(Seventh) and 12 CFR Part 1. Banking entities that rely on the proposed rule of construction to invest alongside a covered fund that is organized and offered by the banking entity pursuant to § __.11 would still be required to comply with all of the conditions under § __.11 with respect to the covered fund, which would, among other things, prohibit the banking entity from guaranteeing, assuming, or otherwise insuring the obligations or performance of the covered fund. As a result, the banking entity would not be permitted to make a direct investment alongside a covered fund that the banking entity organizes and offers for the purpose of artificially maintaining or increasing the value of the fund's positions. The banking entity would also need to ensure that any such direct investment alongside an organized and offered covered fund does not cause the sponsoring banking entity's permitted organizing and offering activities to violate the prudential backstops under § __.15.²⁴⁴ In particular, to the extent the investment would result in a material conflict of interest between the banking entity and its clients, for example because the banking entity may exit the position at a different time or on different terms than the covered fund, the banking entity would be required to provide timely and effective disclosure in accordance with § __.15(b) prior to making the investment.

The 2013 rule imposes certain attribution rules and eligibility requirements for investments by directors and employees of a banking entity in covered funds organized and offered by the banking entity. Specifically, § __.12(b)(1)(iv) of the 2013 rule requires attribution of an investment by a director or employee of a banking entity who acquires an ownership

²⁴⁴ The agencies note that the banking entity's direct investment would not itself be subject to § __.15.

interest in his or her personal capacity in a covered fund sponsored by the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund. Section __.11(a)(7) prohibits investments by any director or employee of the banking entity (or an affiliate thereof) in the covered fund, other than any director or employee who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee makes the investment.

The agencies recognize that directors and employees of banking entities may participate in investments alongside a covered fund, for example on an ad hoc basis or as part of a compensation arrangement. Consistent with the agencies' proposed rule of construction regarding direct investments by banking entities alongside a covered fund, the agencies would expect that any direct investments (whether a series of parallel investments or a co-investment) by a director or employee of a banking entity (or an affiliate thereof) made alongside a covered fund in compliance with applicable laws and regulations would not be treated as an investment by the director or employee in the covered fund. Accordingly, such a direct investment would not be attributed to the banking entity as an investment in the covered fund, regardless of whether the banking entity arranged the transaction on behalf of the director or employee or provided financing for the investment.²⁴⁵ Similarly, the requirements under § __.11(a)(7) limiting the directors and employees that are eligible to invest in a covered fund organized and

²⁴⁵ See proposed rule § __.12(b)(1)(iv) (requiring attribution of an investment by a director or employee *in a covered fund* where the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the covered fund and the financing is used to acquire such ownership interest in the covered fund).

offered by the banking entity to those that are directly engaged in providing specified services to the covered fund would not apply to any such direct investment.

The proposed rule of construction would not prohibit a banking entity from having investment policies, arrangements or agreements to invest alongside a covered fund in all or substantially all of the investments made by the covered fund or to fund all or any portion of the investment opportunities made available by the covered fund to other investors. Accordingly, a banking entity could market a covered fund it organizes and offers pursuant to § __.11 on the basis of the banking entity's expectation that it would invest in parallel with the covered fund in some or all of the same investments, or the expectation that the banking entity would fund one or more co-investment opportunities made available by the covered fund. The agencies would expect that any such investment policies, arrangements or agreements would ensure that the banking entity has the ability to evaluate each investment on a case-by-case basis to confirm that the banking entity does not make any investment unless the investment complies with applicable laws and regulations, including any applicable safety and soundness standards. The agencies believe that this would further ensure that the banking entity is not exposed to the types of risks that section 13 of the BHC Act was intended to address.

The agencies recognize that the 2011 proposed rule would have required a banking entity to apply the per fund limit and aggregate fund limit to a direct investment alongside a covered fund when, among other things, a banking entity is contractually obligated to make such investment alongside a covered fund. The agencies do not believe such a prohibition is necessary given the agencies' expectation that a banking entity would retain the ability to evaluate each investment on a case-by-case basis to confirm that the banking entity does not

make any investment unless the investment complies with applicable laws and regulations, including any applicable safety and soundness standards.

Question 83. Should the agencies adopt the proposed rule of construction in § __.12(b)(5) that would address direct investments made by banking entities alongside covered funds by clarifying in the rule text that banking entities are not required to treat such direct investments alongside a covered fund as an investment in the covered fund as long as the investment is made in compliance with applicable laws and regulations? Why or why not? What, if any, modifications to the scope of the proposed rule of construction should be made? Is the proposed condition on the proposed rule of construction appropriate? If not, how should the agencies modify the condition, and why? Should the agencies provide any additional guidance or requirements regarding the condition?

Question 84. Do commenters believe that the proposed rule of construction will provide banking entities with clarity about how a banking entity should treat its otherwise permissible investments alongside a covered fund under the implementing regulations? Why or why not? If not, what additional modifications should be made?

Question 85. Would the proposed rule of construction create any opportunities for evasion, for example, by allowing a banking entity to structure parallel investments and co-investments to evade the restrictions of section 13? Why or why not? If so, how could such concerns be addressed? Please explain.

Question 86. Do commenters agree that investments made by a director or employee alongside a covered fund should not be treated as an investment in the covered fund? Why or why not? Do commenters agree that the requirements under § __.11(a)(7) that limit the directors and employees that are eligible to invest in a covered fund organized and offered by the banking

entity to those who are directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund should not apply to any such investment? Why or why not? Should the agencies provide additional rule text addressing director and employee investments alongside covered funds? Are there any additional conditions that the agencies should consider placing on director and employee investments made alongside a covered fund? Are there any modifications to the agencies' proposed treatment of director and employee investments or proposed rule of construction that commenters believe is necessary in order to accommodate director and employee investments alongside a covered fund that are made through employee securities companies or other types of employee compensation arrangements? If so, please explain what modifications would be necessary or appropriate and the rationale for such modifications.

Question 87. The proposed rule of construction would not prohibit a banking entity from having investment policies, arrangements or agreements to invest alongside a covered fund in all or substantially all of the investments made by the covered fund or to fund all or any portion of the investment opportunities made available by the covered fund to other investors. Should the agencies impose any additional limitations on a banking entity's investment policies, arrangements or agreements to invest alongside a covered fund? Why or why not? If the agencies were to impose such limitations, should the agencies adopt the approach used to define "contractual obligation" in the Conformance Rule?²⁴⁶ Why or why not?

²⁴⁶ See A Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 FR 8265 (Feb. 14, 2011) (the Conformance Rule).

G. Technical Amendments

The agencies are proposing five sets of clarifying technical edits to the implementing regulations. Specifically, the agencies are proposing to (1) amend § ____.12(b)(1)(ii) to add a comma after the words “SEC-regulated business development companies” in both places where that phrase is used; (2) amend § ____.12(b)(4)(i) to replace the phrase “ownership interest of the master fund” with the phrase “ownership interest in the master fund”; (3) amend § ____.12(b)(4)(ii) to replace the phrase “ownership interest of the fund” with the phrase “ownership interest in the fund;” (4) amend §§ __.10(c)(3)(i) and __.10(c)(10)(i) to replace the word “comprised” with the word “composed;” and (5) amend § __.10(c)(8)(iv)(A) to replace the word “of” in the phrase “contractual rights of other assets” with the word “or.”

IV. Administrative Law Matters

A. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000.²⁴⁷ The Federal banking agencies have sought to present the proposal in a simple and straightforward manner, and invite your comments on how to make this proposal easier to understand.

For example:

- *Have the agencies organized the material to suit your needs? If not, how could this material be better organized?*
- *Are the requirements in the proposal clearly stated? If not, how could the proposal be more clearly stated?*

²⁴⁷ Pub. L. 106-102, 113 Stat. 1338, 1471, 12 U.S.C. 4809.

- *Does the proposal contain language or jargon that is not clear? If so, which language requires clarification?*
- *Would a different format (e.g., grouping and order of sections, use of headings, paragraphing) make the proposal easier to understand? If so, what changes to the format would make the proposal easier to understand?*
- *Would more, but shorter, sections be better? If so, which sections should be changed?*
- *What else could the agencies do to make the regulation easier to understand?*

B. Paperwork Reduction Act Analysis Request for Comment on Proposed Information Collection

Certain provisions of the proposed rule contain “collection of information” requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521). In accordance with the requirements of the PRA, the agencies may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The agencies reviewed the proposed rule and determined that the proposed rule creates new recordkeeping requirements and revises certain disclosure requirements that have been previously cleared under various OMB control numbers. The agencies are proposing to extend for three years, with revision, these information collections. The information collection requirements contained in this joint notice of proposed rulemaking have been submitted by the OCC and FDIC to OMB for review and approval under section 3507(d) of the PRA (44 U.S.C. 3507(d)) and section 1320.11 of the OMB’s implementing regulations (5 CFR 1320). The Board reviewed the proposed rule under the authority delegated to the Board by OMB. The Board will submit information collection burden estimates to OMB and the submission will include burden for Federal Reserve-supervised

institutions, as well as burden for OCC-, FDIC-, SEC-, and CFTC-supervised institutions under a holding company. The OCC and the FDIC will take burden for banking entities that are not under a holding company.

Comments are invited on:

a. Whether the collections of information are necessary for the proper performance of the agencies' functions, including whether the information has practical utility;

b. The accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

c. Ways to enhance the quality, utility, and clarity of the information to be collected;

d. Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology;
and

e. Estimates of capital or startup costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the ADDRESSES section. A copy of the comments may also be submitted to the OMB desk officer for the agencies by mail to U.S. Office of Management and Budget, 725 17th Street NW, #10235, Washington, DC 20503, by facsimile to 202-395-5806, or by email to oir_submission@omb.eop.gov, Attention, Federal Banking Agency and Commission Desk Officer.

Abstract

Section 13 of the BHC Act, which generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions. The exemptions allow certain types of permissible trading activities such as underwriting, market making, and risk-mitigating hedging, among others. The 2013 rule implementing section 13 became effective on April 1, 2014. Section __.20(d) and Appendix A of the 2013 final rule require certain of the largest banking entities to report to the appropriate agency certain quantitative measurements.

Current Actions

The proposed rule contains requirements subject to the PRA and the proposed changes relative to the current final rule are discussed herein. The new recordkeeping requirements are found in section __.10(c)(18)(ii)(B)(1) and the modified disclosure requirements are found in section __.11(a)(8)(i). The modified information collection requirements would implement section 13 of the BHC Act. The respondents are for-profit financial institutions, including small businesses. A covered entity must retain these records for a period that is no less than 5 years in a form that allows it to promptly produce such records to the relevant Agency on request.

Recordkeeping Requirements

Section __.10(c)(18)(ii)(B)(1) would require a banking entity relying on the proposed exclusion from the covered fund definition for customer facilitation vehicles to maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to a transaction, investment strategy, or service. The agencies estimate that the new recordkeeping requirement would be incurred once a year with an average hour per response of 10 hours.

Disclosure Requirements

Section __.11(a)(8)(i), which requires banking entities that organize and offer covered funds to make certain disclosures to investors in such funds, would be expanded to also apply to banking entities sponsoring credit funds, venture capital funds, family wealth management vehicles, or customer facilitation vehicles, in reliance on the proposed exclusions for such funds. The agencies estimate that the current average hours per response of 0.1 would increase to 0.5.

Proposed Revision, With Extension, of the Following Information Collections

Estimated average hours per response:

Reporting

Section __.4(c)(3)(i) – 0.25 hours for an average of 20 times per year.

Section __.12(e) – 20 hours (Initial set-up 50 hours) for an average of 10 times per year.

Section __.20(d) – 41 hours (Initial set-up 125 hours) quarterly.

Section __.20(i) – 20 hours.

Recordkeeping

Section __.3(d)(3) – 1 hour (Initial set-up 3 hours).

Section __.4(b)(3)(i)(A) – 2 hours quarterly.

Section __.4(c)(3)(i) – 0.25 hours for an average of 40 times per year.

Section __.5(c) – 40 hours (Initial setup 80 hours).

Section __.10(c)(18)(ii)(B)(1) – 10 hours.

Section __.11(a)(2) – 10 hours.

Section __.20(b) – 265 hours (Initial set-up 795 hours).

Section __.20(c) – 100 hours (Initial set-up 300 hours).

Section __.20(d) – 10 hours.

Section __.20(e) – 200 hours.

Section __.20(f)(1) – 8 hours.

Section __.20(f)(2) – 40 hours (Initial set-up 100 hours).

Disclosure

Section __.11(a)(8)(i) – 0.5 hours for an average of 26 times per year.

OCC

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements
Associated with Restrictions on Proprietary Trading and Certain Relationships with Hedge
Funds and Private Equity Funds.

Frequency: Annual, quarterly, and event driven.

Affected Public: Businesses or other for-profit.

Respondents: National banks, state member banks, state nonmember banks, and state and federal savings associations.

OMB control number: 1557-0309.

Estimated number of respondents: 39.

Proposed revisions estimated annual burden: 302 hours.

Estimated annual burden hours: 20,410 hours (3,681 hour for initial set-up and 16,729 hours for ongoing).

Board

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements
Associated with Regulation VV.

Frequency: Annual, quarterly, and event driven.

Affected Public: Businesses or other for-profit.

Respondents: State member banks, bank holding companies, savings and loan holding companies, foreign banking organizations, U.S. State branches or agencies of foreign banks, and other holding companies that control an insured depository institution and any subsidiary of the foregoing other than a subsidiary for which the OCC, FDIC, CFTC, or SEC is the primary financial regulatory agency. The Board will take burden for all institutions under a holding company including:

- OCC-supervised institutions,
- FDIC-supervised institutions,
- Banking entities for which the CFTC is the primary financial regulatory agency, as defined in section 2(12)(C) of the Dodd-Frank Act, and
- Banking entities for which the SEC is the primary financial regulatory agency, as defined in section 2(12)(B) of the Dodd-Frank Act.

Legal authorization and confidentiality: This information collection is authorized by section 13 of the BHC Act (12 U.S.C. 1851(b)(2) and 12 U.S.C. 1851(e)(1)). The information collection is required in order for covered entities to obtain the benefit of engaging in certain types of proprietary trading or investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund, under the restrictions set forth in section 13 and the final rule. If a respondent considers the information to be trade secrets and/or privileged such information could be withheld from the public under the authority of the Freedom of Information Act (5 U.S.C. 552(b)(4)). Additionally, to the extent that such information may be contained in an examination report such information could also be withheld from the public (5 U.S.C. 552 (b)(8)).

Agency form number: FR VV.

OMB control number: 7100-0360.

Estimated number of respondents: 255.

Proposed revisions estimated annual burden: 7,880 hours.

Estimated annual burden hours: 36,112 hours (4,381 hour for initial set-up and 31,731 hours for ongoing).

FDIC

Title of Information Collection: Volcker Rule Restrictions on Proprietary Trading and Relationships with Hedge Funds and Private Equity Funds.

Frequency: Annual, quarterly, and event driven.

Affected Public: Businesses or other for-profit.

Respondents: State nonmember banks, state savings associations, and certain subsidiaries of those entities.

OMB control number: 3064-0184.

Estimated number of respondents: 10.

Proposed revisions estimated annual burden: 170 hours.

Estimated annual burden hours: 3,283 hours (1,754 hours for initial set-up and 1,529 hours for ongoing).

C. Initial Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (“RFA”)²⁴⁸ requires an agency to either provide an initial regulatory flexibility analysis with a proposed rule or certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. The U.S. Small Business Administration (“SBA”) establishes size standards that define which entities are small

²⁴⁸ 5 U.S.C. 601 *et seq.*

businesses for purposes of the RFA.²⁴⁹ Except as otherwise specified below, the size standard to be considered a small business for banking entities subject to the proposal is \$600 million or less in consolidated assets.²⁵⁰

Board

The Board has considered the potential impact of the proposed rule on small entities in accordance with section 603 of the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial number of small entities.

The Board welcomes comment on all aspects of its analysis. In particular, the Board requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

As discussed in the **Supplementary Information**, the agencies are proposing revisions to the regulations implementing section 13 of the BHC Act in order to improve and streamline the regulations by modifying and clarifying requirements related to the covered fund provisions.²⁵¹ Certain of the proposed exclusions from the covered fund definition may contain recordkeeping and disclosure requirements that would apply to banking entities relying on the exclusion. For example, the proposed exclusion for customer facilitation vehicles would require a banking entity relying on the exclusion to maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to a transaction, investment strategy, or service.

²⁴⁹ U.S. SBA, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, *available at* <https://www.sba.gov/document/support--table-size-standards>.

²⁵⁰ *See id.* Pursuant to SBA regulations, the asset size of a concern includes the assets of the concern whose size is at issue and all of its domestic and foreign affiliates. 13 CFR 121.103(6).

²⁵¹ The agencies are explicitly authorized under section 13(b)(2) of the BHC Act to adopt rules implementing section 13. 12 U.S.C. 1851(b)(2).

The proposed changes are expected to reduce regulatory burden on banking entities, and the Board does not expect these proposed recordkeeping requirements to result in a significant economic impact.

The Board's rule generally applies to state-chartered banks that are members of the Federal Reserve System, bank holding companies, and foreign banking organizations and nonbank financial companies supervised by the Board (collectively, "Board-regulated entities"). However, section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),²⁵² which was enacted on May 24, 2018, amended section 13 of the BHC Act by narrowing the definition of banking entity to exclude certain community banks.²⁵³ The Board is not aware of any Board-regulated entities that meet the SBA's definition of "small entity" that are subject to section 13 of the BHC Act and its implementing regulations following the enactment of EGRRCPA. Furthermore, to the extent that any Board-regulated entities that meet the definition of "small entity" are or become subject to section 13 of the BHC Act and its implementing regulations, the Board does not expect the total number of such entities to be substantial. Accordingly, the Board's proposed rule is not expected to have a significant economic impact on a substantial number of small entities.

The Board has not identified any federal statutes or regulations that would duplicate, overlap, or conflict with the proposed revisions, and the Board is not aware of any significant alternatives to the final rule that would reduce the economic impact on Board-regulated small entities.

²⁵² Pub. L. 115–174 (May 24, 2018).

²⁵³ Under EGRRCPA, a community bank and its affiliates are generally excluded from the definition of banking entity, and thus section 13 of the BHC Act, if the bank and all companies that control the bank have total consolidated assets equal to \$10 billion or less and trading assets and liabilities equal to 5 percent or less of total consolidated assets.

OCC

The OCC certifies that this regulation, if adopted, will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.

The Regulatory Flexibility Act requires an agency, in connection with a proposed rule, to prepare an Initial Regulatory Flexibility Analysis describing the impact of the proposed rule on small entities, or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. For purposes of the Regulatory Flexibility Act, the SBA includes as small entities those with \$600 million or less in assets for commercial banks and savings institutions, and \$41.5 million or less in assets for trust companies.

The OCC currently supervises approximately 782 small entities.²⁵⁴

Under the Economic Growth, Regulatory Relief, and Consumer Protection Act, banking entities with total consolidated assets of \$10 billion or less generally are not “banking entities” within the scope of section 13 of the BHC Act if their trading assets and trading liabilities do not exceed 5 percent of their total consolidated assets. In addition, certain trust-only banks are generally not banking entities within the scope of section 13 of the BHC Act. Because there are no OCC-supervised small entities that are banking entities within the scope of section 13 of the BHC Act, the proposal would not impact any OCC-supervised small entities. Therefore, the

²⁵⁴ The number of small entities supervised by the OCC is determined using the SBA’s size thresholds for commercial banks and savings institutions, and trust companies, which are \$600 million and \$41.5 million, respectively. Consistent with the General Principles of Affiliation 13 CFR 121.103(a), we count the assets of affiliated financial institutions when determining if we should classify an OCC-supervised institution as a small entity. We use December 31, 2018, to determine size because a “financial institution’s assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.” See footnote 8 of the U.S. Small Business Administration’s *Table of Size Standards*.

OCC certifies that the proposal, if implemented, would not have a significant economic impact on a substantial number of small entities.

FDIC

The RFA generally requires that, in connection with a proposed rulemaking, an agency prepare and make available for public comment an initial regulatory flexibility analysis describing the impact of the proposed rule on small entities.²⁵⁵ However, a regulatory flexibility analysis is not required if the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. The SBA - has defined “small entities” to include banking organizations with total assets of less than or equal to \$600 million that are independently owned and operated or owned by a holding company with less than or equal to \$600 million in total assets.²⁵⁶ Generally, the FDIC considers a significant effect to be a quantified effect in excess of 5 percent of total annual salaries and benefits per institution, or 2.5 percent of total non-interest expenses. The FDIC believes that effects in excess of these thresholds typically represent significant effects for FDIC-supervised institutions. For the reasons described below and under section 605(b) of the RFA, the FDIC certifies that this rule will not have a significant economic impact on a substantial number of small entities.

²⁵⁵ 5 U.S.C. 601 et seq.

²⁵⁶ The SBA defines a small banking organization as having \$600 million or less in assets, where an organization's “assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.” *See* 13 CFR 121.201 (as amended by 84 FR 34261, effective August 19, 2019). In its determination, the “SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates.” *See* 13 CFR 121.103. Following these regulations, the FDIC uses a covered entity’s affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the covered entity is “small” for the purposes of RFA.

As of June 30, 2019, the FDIC supervised 3,424 depository institutions,²⁵⁷ of which 2,665 were considered small entities for the purposes of RFA. The Economic Growth, Regulatory Relief, and Consumer Protection Act exempted banking entities from the requirements of section 13 of the BHC Act if they have total assets below \$10 billion and trading assets and liabilities comprising less than five percent of total consolidated assets.²⁵⁸ Only one small, FDIC-supervised institution is subject to Section 13, because its trading assets and liabilities exceed five percent of total consolidated assets.²⁵⁹

Section 13 of the BHC Act generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund. As previously discussed, the proposed rule would modify existing definitions and exclusions, as well as would introduce new exclusions to the implementing regulations. If adopted, the proposed rule would permit covered entities to engage in additional activities with respect to covered funds, including acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with covered funds, subject to certain restrictions.

This proposed rule would exclude certain types of institutions from the definition of a “covered fund” for the purposes of section 13 of the BHC Act. Investments in funds that are affected by this proposed rule could be reported as deductions from capital on Call Report schedule RCR Part 1 Lines 11 or 13 if the investments qualify as “investments in the capital of an unconsolidated financial institution” or as additional deductions on Lines 17 or 24 of schedule

²⁵⁷ FDIC-supervised institutions are set forth in 12 U.S.C. 1813(q)(2).

²⁵⁸ Pub. L. 115-174, May 24, 2018. <https://www.congress.gov/bill/115th-congress/senate-bill/2155>

²⁵⁹ Call Report data, June 2019.

RC-R otherwise.²⁶⁰ The one affected small, FDIC-supervised institution did not report any such deductions over the past five years.²⁶¹

Based on this supporting information, the FDIC certifies that this rule will not have a significant economic impact on a substantial number of small entities.

SEC

Pursuant to 5 U.S.C. section 605(b), the SEC hereby certifies that the proposed rule would not, if adopted, have a significant economic impact on a substantial number of small entities.

As discussed in the Supplementary Information, the proposed rule is intended to continue the agencies' efforts to improve and streamline the regulations implementing section 13 of the BHC Act by modifying and clarifying requirements related to the covered fund provisions. To minimize the costs associated with the 2013 rule in a manner consistent with section 13 of the BHC Act, the agencies are proposing to simplify and tailor the rule in a manner that would reduce compliance costs for banking entities subject to section 13 of the BHC Act and the implementing regulations.

The proposed revisions would generally apply to banking entities, including certain SEC-registered entities. These entities include bank-affiliated SEC-registered investment advisers, broker-dealers, and security-based swap dealers. Based on information in filings submitted by these entities, the SEC preliminarily believes that there are no banking entity registered investment advisers or broker-dealers that are small entities for purposes of the RFA. For this

²⁶⁰ See "Supervisory Guidance on the Capital Treatment of Certain Investments in Covered Funds." FDIC FIL-50-2015: November 6, 2015.

<https://www.fdic.gov/news/news/financial/2015/fil15050a.pdf>

²⁶¹ Call Report data, March 2014 – June 2019.

reason, the SEC believes that the proposed rule would not, if adopted, have a significant economic impact on a substantial number of small entities.

The SEC encourages written comments regarding this certification. Specifically, the SEC solicits comment as to whether the proposed rule could have an impact on small entities that has not been considered. Commenters should describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

CFTC

Pursuant to 5 U.S.C. 605(b), the CFTC hereby certifies that the proposed amendments to the 2013 final rule would not, if adopted, have a significant economic impact on a substantial number of small entities for which the CFTC is the primary financial regulatory agency.

As discussed in this **Supplementary Information**, the agencies are proposing specific changes to the restrictions on covered fund investments and activities and other issues related to the treatment of investment funds in the implementing regulations. The proposed rule is intended to improve and streamline the covered fund provisions and facilitate banking entities' permissible activities and offering of financial services in a manner that is consistent with the requirements of section 13 of the BHC Act. The proposal would exempt the activities of certain qualifying foreign excluded funds from the restrictions of the implementing regulations, make modifications to several existing exclusions from the covered funds provisions and adopt several new exclusions, permit a banking entity to engage in a limited set of covered transactions with a related covered fund, and clarify certain aspects of the definition of ownership interest.

The proposed revisions would generally apply to banking entities, including certain CFTC-registered entities. These entities include bank-affiliated CFTC-registered swap dealers,

futures commission merchants, commodity trading advisors and commodity pool operators.²⁶²

The CFTC has previously determined that swap dealers, futures commission merchants and commodity pool operators are not small entities for purposes of the RFA and, therefore, the requirements of the RFA do not apply to those entities.²⁶³ As for commodity trading advisors, the CFTC has found it appropriate to consider whether such registrants should be deemed small entities for purposes of the RFA on a case-by-case basis, in the context of the particular regulation at issue.²⁶⁴

In the context of the proposed revisions to the implementing regulations, the CFTC believes it is unlikely that a substantial number of the commodity trading advisors that are potentially affected are small entities for purposes of the RFA. In this regard, the CFTC notes that only commodity trading advisors that are registered with the CFTC are covered by the implementing regulations, and generally those that are registered have larger businesses. Similarly, the implementing regulations apply to only those commodity trading advisors that are affiliated with banks, which the CFTC expects are larger businesses. The CFTC requests that commenters address in particular whether any of these commodity trading advisors, or other CFTC registrants covered by the proposed revisions to the implementing regulations, are small entities for purposes of the RFA.

²⁶² The proposed revisions may also apply to other types of CFTC registrants that are banking entities, such as introducing brokers, but the CFTC believes it is unlikely that such other registrants will have significant activities that would implicate the proposed revisions. *See* 79 FR 5808, 5813 (Jan. 31, 2014) (CFTC version of 2013 final rule).

²⁶³ *See* Policy Statement and Establishment of Definitions of “Small Entities” for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982) (futures commission merchants and commodity pool operators); Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620 (Jan. 19, 2012) (swap dealers and major swap participants).

²⁶⁴ *See* Policy Statement and Establishment of Definitions of “Small Entities” for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18620 (Apr. 30, 1982).

Because the CFTC believes that there are not a substantial number of registered, banking entity-affiliated commodity trading advisors that are small entities for purposes of the RFA, and the other CFTC registrants that may be affected by the proposed revisions have been determined not to be small entities, the CFTC believes that the proposed revisions to the implementing regulations would not, if adopted, have a significant economic impact on a substantial number of small entities for which the CFTC is the primary financial regulatory agency.

The CFTC encourages written comments regarding this certification. Specifically, the CFTC solicits comment as to whether the proposed amendments could have a direct impact on small entities that were not considered. Commenters should describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

D. Riegle Community Development and Regulatory Improvement Act

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA), 12 USC 4802(a), in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency must consider, consistent with the principles of safety and soundness and the public interest: (1) any administrative burdens that the proposed rule would place on depository institutions, including small depository institutions and customers of depository institutions, and (2) the benefits of the proposed rule. In addition, section 302(b) of RCDRIA, 12 U.S.C. 4802(b), requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are

published in final form. The Federal banking agencies invite any comment that would inform consideration under RCDRIA.

E. OCC Unfunded Mandates Reform Act

The OCC has analyzed the proposed rule under the factors in the Unfunded Mandates Reform Act of 1995 (UMRA).²⁶⁵ Under this analysis, the OCC considered whether the proposed rule includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year (adjusted annually for inflation). The UMRA does not apply to regulations that incorporate requirements specifically set forth in law.

The proposed rule does not impose new mandates. Therefore, the OCC finds that the proposed rule does not trigger the UMRA cost threshold. Accordingly, the OCC has not prepared the written statement described in section 202 of the UMRA.

F. SEC Economic Analysis

[Placeholder for SEC Economic Analysis.]

G. SEC Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or “SBREFA,”²⁶⁶ the SEC requests comment on the potential effect of the proposed rule on the U.S. economy on an annual basis; any potential increase in costs or prices for consumers or individual industries; and any potential effect on competition, investment or innovation.

²⁶⁵ 2 U.S.C. 1531 et seq.

²⁶⁶ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons stated in the Common Preamble, the Office of the Comptroller of the Currency proposes to amend chapter I of Title 12, Code of Federal

Regulations as follows:

PART 44 PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

1. The authority citation for part 44 continues to read as follows:

Authority: 7 U.S.C. 27 *et seq.*, 12 U.S.C. 1, 24, 92a, 93a, 161, 1461, 1462a, 1463, 1464, 1467a, 1813(q), 1818, 1851, 3101, 3102, 3108, 5412.

Subpart B — Proprietary Trading

2. In subpart B, section 44.6 is amended by adding paragraph (f) to read as follows:

§ 44.6. Other permitted proprietary trading activities.

* * * * *

(f) *Permitted trading activities of qualifying foreign excluded funds.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale of a financial instrument by a qualifying foreign excluded fund. For purposes of this paragraph (f), a qualifying foreign excluded fund means a banking entity that:

(1) Is organized or established outside the United States, and the ownership interests of which are offered and sold solely outside the United States;

(2)(i) Would be a covered fund if the entity were organized or established in the United States, or

(ii) 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;

(3) 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 § 44.13(b);

(4) Is established and operated as part of a bona fide asset management business; and

(5) Is not operated in a manner that enables any other banking entity to evade the requirements of section 13 of the BHC Act or this part.

Subpart C — Covered Funds Activities and Investments

3. In subpart C, section 44.10 is amended by:

- a. Revising paragraph (c)(1);
- b. Revising paragraph (c)(3)(i);
- c. Revising paragraph (c)(8);
- d. Revising paragraph (c)(10)(i);
- e. Revising paragraph (c)(11)(i);
- f. Adding paragraphs (c)(15), (16), (17), and (18); and
- g. Revising paragraph (d)(6).

The revisions and additions read as follows:

§ 44.10. Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

* * * * *

(c) * * *

(1) *Foreign public funds.*

(i) Subject to paragraphs (c)(1)(ii) and (iii) of this section, an issuer that:

(A) Is organized or established outside of the United States; and

(B) Is authorized to offer and sell ownership interests, and such interests are offered and sold, through one or more public offerings.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and senior executive officers as defined in section 225.71(c) of the Board's Regulation Y (12 CFR 225.71(c)) of such entities.

(iii) For purposes of paragraph (c)(1)(i)(B) of this section, the term "public offering" means a distribution (as defined in § 44.4(a)(3) of subpart B of this part) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution is subject to substantive disclosure and retail investor protection laws or regulations;

(B) With respect to an issuer for which the banking entity serves as the investment manager, investment adviser, commodity trading adviser, commodity pool operator, or sponsor, the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(C) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(D) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

* * * * *

(3) * * *

(i) Is composed of no more than 10 unaffiliated co-venturers;

* * * * *

(8) *Loan securitizations*—(i) *Scope*. An issuing entity for asset-backed securities that satisfies all the conditions of this paragraph (c)(8) and the assets or holdings of which are composed solely of:

(A) Loans as defined in § 44.2(t) of subpart A;

(B) Rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset that is a security (other than special units of beneficial interest and collateral certificates meeting the requirements of paragraph (c)(8)(v) of this section) meets the requirements of paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(E) Any other assets, provided that the aggregate value of any such other assets that do not meet the criteria specified in paragraphs (c)(8)(i)(A) through (c)(8)(i)(D) of this section do not exceed five percent of the aggregate value of the issuing entity's assets.

(ii) *Impermissible assets.* For purposes of this paragraph (c)(8), except as permitted under paragraph (c)(8)(i)(E) above, the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraphs (c)(8)(iii), (iv), or (v) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities.* Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents – which, for the purposes of this paragraph, means high quality, highly liquid investments whose maturity corresponds to the securitization's expected or potential need for funds and whose currency corresponds to either the underlying loans or the asset-backed securities – for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives.* The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivatives directly relate to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph

(c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates.* The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in this paragraph (c)(8);

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under this paragraph (c)(8) and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

* * * * *

(10) *Qualifying covered bonds*—(i) *Scope*. An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are composed solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

* * * * *

(11) * * *

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked, or that has voluntarily surrendered its license to operate as a small business investment company in accordance with 13 CFR 107.1900 and does not make any new investments (other than investments in cash equivalents, which, for the purposes of this paragraph, means high quality, highly liquid investments whose maturity corresponds to the issuer's expected or potential need for funds and whose currency corresponds to the issuer's assets) after such voluntary surrender; or

* * * * *

(15) *Credit funds*. Subject to paragraphs (c)(15)(iii), (iv), and (v) of this section, an issuer that satisfies the asset and activity requirements of paragraphs (c)(15)(i) and (ii) of this section.

(i) *Asset requirements*. The issuer's assets must be composed solely of:

(A) Loans as defined in § 44.2(t) of subpart A;

(B) Debt instruments, subject to paragraph (c)(15)(iv) of this section;

(C) Rights and other assets that are related or incidental to acquiring, holding, servicing, or selling such loans or debt instruments, provided that:

- (I) Each right or asset that is a security is either:
- (i) A cash equivalent (which, for the purposes of this paragraph, means high quality, highly liquid investments whose maturity corresponds to the issuer's expected or potential need for funds and whose currency corresponds to either the underlying loans or the debt instruments);
 - (ii) A security received in lieu of debts previously contracted with respect to such loans or debt instruments; or
 - (iii) An equity security (or right to acquire an equity security) received on customary terms in connection with such loans or debt instruments; and
- (2) Rights or other assets held under this paragraph (c)(15)(i)(C) may not include commodity forward contracts; and
- (D) Interest rate or foreign exchange derivatives, if:
- (1) The written terms of the derivative directly relate to the loans, debt instruments, or other rights or assets described in paragraph (c)(15)(i)(C) of this section; and
 - (2) The derivative reduces the interest rate and/or foreign exchange risks related to the loans, debt instruments, or other rights or assets described in paragraph (c)(15)(i)(C) of this section.
- (ii) *Activity requirements.* To be eligible for the exclusion of paragraph (c)(15) of this section, an issuer must:
- (A) Not engage in any activity that would constitute proprietary trading under § 44.3(b)(1)(i) of subpart A, as if the issuer were a banking entity; and
 - (B) Not issue asset-backed securities.
- (iii) *Requirements for a sponsor, investment adviser, or commodity trading advisor.* A banking entity that acts as a sponsor, investment adviser, or commodity trading advisor to an issuer that

meets the conditions in paragraphs (c)(15)(i) and (ii) of this section may not rely on this exclusion unless the banking entity:

(A) Provides in writing to any prospective and actual investor in the issuer the disclosures required under § 44.11(a)(8) of this subpart, as if the issuer were a covered fund; and

(B) Ensures that the activities of the issuer 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.

(iv) A banking entity may not rely on this exclusion with respect to an issuer that meets the conditions in paragraphs (c)(15)(i) and (ii) of this section unless:

(A) The banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the issuer or of any entity to which such issuer extends credit or in which such issuer invests; and

(B) Any assets the issuer holds pursuant to paragraphs (c)(15)(i)(B) or (i)(C)(I)(iii) of this section would be permissible for the banking entity to acquire and hold directly.

(v) A banking entity's investment in, and relationship with, the issuer must:

(A) Comply with the limitations imposed in §§ 44.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 44.15 of this subpart, as if the issuer were a covered fund; and

(B) Be conducted in compliance with, and subject to, applicable banking laws and regulations, including applicable safety and soundness standards.

(16) *Qualifying venture capital funds.*

(i) Subject to paragraphs (c)(16)(ii) through (iv) of this section, an issuer that:

(A) Is a venture capital fund as defined in 17 CFR 275.203(I)-1; and

(B) Does not engage in any activity that would constitute proprietary trading under section 44.3(b)(1)(i), as if the issuer were a banking entity.

(ii) A banking entity that acts as a sponsor, investment adviser, or commodity trading advisor to an issuer that meets the conditions in paragraph (c)(16)(i) of this section may not rely on this exclusion unless the banking entity:

(A) Provides in writing to any prospective and actual investor in the issuer the disclosures required under § 44.11 (a)(8) of this subpart, as if the issuer were a covered fund; and

(B) Ensures that the activities of the issuer 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.

(iii) The banking entity must not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the issuer.

(iv) A banking entity's ownership interest in or relationship with the issuer must:

(A) Comply with the limitations imposed in §§ 44.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 44.15 of this subpart, as if the issuer were a covered fund; and

(B) Be conducted in compliance with, and subject to, applicable banking laws and regulations, including applicable safety and soundness standards.

(17) *Family wealth management vehicles.* (i) Subject to paragraph (c)(17)(ii) of this section, 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, and:

(A) If the entity is a trust, the grantor(s) of the entity are all family customers; and

(B) If the entity is not a trust:

(1) A majority of the voting interests in the entity are owned (directly or indirectly) by family customers; and

(2) The entity is owned only by family customers and up to 3 closely related persons of the family customers.

(ii) A banking entity may rely on the exclusion in paragraph (c)(17)(i) of this section with respect to an entity provided that the banking entity (or an affiliate):

(A) Provides bona fide trust, fiduciary, investment advisory, or commodity trading advisory services to the entity;

(B) Does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such entity;

(C) Complies with the disclosure obligations under § 44.11(a)(8), as if such entity were a covered fund;

(D) 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;

(E) Complies with the requirements of §§ 44.14(b) and 44.15, as if such entity were a covered fund; and

(F) Complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof.

(iii) For purposes of paragraph (c)(17) of this section, the following definitions apply:

(A) “Closely related person” means a natural person (including the estate and estate planning vehicles of such person) who has longstanding business or personal relationships with any family customer.

(B) “Family customer” means:

(1) A family client, as defined in Rule 202(a)(11)(G)-1(d)(4) of the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1(d)(4)); or

(2) 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, or a spouse or a spousal equivalent of any of the foregoing.

(18) *Customer facilitation vehicles.* (i) Subject to paragraph (c)(18)(ii) of this section, an 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.

(ii) A banking entity may rely on the exclusion in paragraph (c)(18)(i) of this section with respect to an issuer provided that:

(A) All of the ownership interests of the issuer are owned by the customer (which may include one or more of its affiliates) for whom the issuer was created, subject to paragraph

(c)(18)(ii)(B)(4) of this section; and

(B) The banking entity and its affiliates:

(1) Maintain documentation outlining how the banking entity intends to facilitate the customer’s exposure to such transaction, investment strategy, or service;

(2) Do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such issuer;

(3) Comply with the disclosure obligations under § 44.11(a)(8), as if such issuer were a covered fund;

(4) Do not acquire or retain, as principal, an ownership interest in the issuer, other than up to 0.5 percent of the issuer'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) Comply with the requirements of §§ 44.14(b) and 44.15, as if such issuer were a covered fund; and

(6) Comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the issuer were an affiliate thereof.

* * * * *

(d) * * *

(6) *Ownership interest*—(i) Ownership interest means any equity, partnership, or other similar interest. An “other similar interest” means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding 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 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);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right 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);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs

(d)(6)(i)(A) through (F) of this section.

(ii) Ownership interest does not include:

(A) *Restricted profit interest*. An interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(I) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided

that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(2) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(3) Any amounts invested in the covered fund, including any amounts paid by the entity in connection with obtaining the restricted profit interest, are within the limits of § 44.12 of this subpart; and

(4) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

(B) Any senior loan or senior debt interest that has the following characteristics:

(1) Under the terms of the interest the holders of such interest do not have the right to receive a share of the income, gains, or profits of the covered fund, but are entitled to receive only:

(i) Interest at a stated interest rate, as well as commitment fees or other fees, which are not determined by reference to the performance of the underlying assets of the covered fund; and

(ii) Fixed principal payments on or before a maturity date (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, foregone income resulting from an early prepayment);

(2) The entitlement to payments under the terms of the interest are absolute and could not be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest; and

(3) The holders of the interest are not entitled to receive the underlying assets of the covered fund after all other interests have been redeemed 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).

4. In subpart C, section 44.12 is amended by:

- a. Revising paragraph (b)(1)(ii);
- b. Revising paragraph (b)(4);
- c. Adding paragraph (b)(5);
- d. Revising paragraph (c)(1);
- e. Revising paragraph (d); and
- f. Revising paragraph (e).

The revisions and addition read as follows:

§ 44.12. Permitted investment in a covered fund.

* * * * *

(b) * * *

(1) * * *

(ii) *Treatment of registered investment companies, SEC-regulated business development companies, and foreign public funds.* For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies, or foreign public fund as described in § 44.10(c)(1) of this subpart will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

* * * * *

(4) *Multi-tier fund investments—(i) Master-feeder fund investments.* If the principal investment strategy of a covered fund (the “feeder fund”) is to invest substantially all of its assets in another single covered fund (the “master fund”), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest in the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments.* If a banking entity organizes and offers a covered fund pursuant to § 44.11 of this subpart for the purpose of investing in other covered funds (a “fund of funds”) and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any

investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest in the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(5) *Parallel Investments and Co-Investments*—(i) A banking entity shall not be required to include in the calculation of the investment limits under paragraph (a)(2) of this section any investment the banking entity makes alongside a covered fund as long as the investment is made in compliance with applicable laws and regulations, including applicable safety and soundness standards.

(ii) A banking entity shall not be restricted under this section in the amount of any investment the banking entity makes alongside a covered fund as long as the investment is made in compliance with applicable laws and regulations, including applicable safety and soundness standards.

(c) * * *

(1)(i) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity in connection with obtaining a restricted profit interest under § 44.10(d)(6)(ii) of this subpart), on a historical cost basis;

(ii) Treatment of employee and director restricted profit interests financed by the banking entity. For purposes of paragraph (c)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires a restricted profit interest in their personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or

employee to acquire the restricted profit interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

* * * * *

(d) *Capital treatment for a permitted investment in a covered fund.* For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1)(i) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity in connection with obtaining a restricted profit interest under § 44.10(d)(6)(ii) of subpart C of this part), on a historical cost basis, plus any earnings received; and

(ii) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (b)(3) of this section (together with any amounts paid by the entity in connection with obtaining a restricted profit interest under § 44.10(d)(6)(ii) of subpart C of this part), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(2) Treatment of employee and director restricted profit interests financed by the banking entity. For purposes of paragraph (d)(1) of this section, an investment by a director or employee of a banking entity who acquires a restricted profit interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the restricted profit interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(e) *Extension of time to divest an ownership interest.* (1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest.

(2) An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(3) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(3) *Factors governing the Board determinations.* In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

- (iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;
- (v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;
- (vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers, or counterparties to which it owes a duty;
- (vii) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;
- (viii) Market conditions; and
- (ix) Any other factor that the Board believes appropriate.

(4) Authority to impose restrictions on activities or investment during any extension period. The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(5) Consultation. In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

5. In subpart C, section 44.13 is amended by adding paragraph (d) to read as follows:

§ 44.13. Other permitted covered fund activities and investments.

* * * * *

(d) Permitted covered fund activities and investments of qualifying foreign excluded funds.

(1) The prohibition contained in § 44.10(a) does not apply to a qualifying foreign excluded fund.

(2) For purposes of this paragraph (d), a qualifying foreign excluded fund means a banking entity that:

(i) Is organized or established outside the United States, and the ownership interests of which are offered and sold solely outside the United States;

(ii)(A) Would be a covered fund if the entity were organized or established in the United States, or

(B) 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;

(iii) 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:

(A) 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

(B) The banking entity's acquisition of an ownership interest in or sponsorship of the fund by the foreign banking entity meets the requirements for permitted covered fund activities and investments solely outside the United States, as provided in section 44.13(b);

(iv) Is established and operated as part of a bona fide asset management business; and

(v) Is not operated in a manner that enables any other banking entity to evade the requirements of section 13 of the BHC Act or this part.

6. In subpart C, section 44.14 is amended by:

- a. Revising paragraph (a)(2)(i);
- b. Revising paragraph (a)(2)(ii)(C);
- c. Adding paragraphs (a)(2)(iii) and (iv); and
- d. Revising paragraph (c).

The revisions and additions read as follows:

§ 44.14. Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of §§ 44.11, 44.12, or 44.13 of this subpart;

(ii) * * *

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity; and

(iii) Enter into a transaction with a covered fund that would be an exempt covered transaction under 12 U.S.C. 371c(d) or section 223.42 of the Board's Regulation W (12 CFR 223.42); and

(iv) Extend credit to or purchase assets from a covered fund, provided:

(A) Each extension of credit or purchase of assets is in the ordinary course of business in connection with payment transactions; settlement services; or futures, derivatives, and securities clearing;

(B) Each extension of credit is repaid, sold, or terminated by the end of five business days; and

(C) The banking entity making each extension of credit meets the requirements of section 223.42(l)(1)(i) and (ii) of the Board's Regulation W (12 CFR 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.

(3) Any transaction or activity permitted under paragraphs (a)(2)(iii) or (iv) must comply with the limitations in § 44.15.

* * * * *

(c) *Restrictions on other permitted transactions.* Any transaction permitted under paragraphs (a)(2)(ii), (a)(2)(iii), or (a)(2)(iv) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c-1) as if the counterparty were an affiliate of the banking entity.