DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 44

[Docket No. OCC–2020–0002]

RIN 1557–AE67

FEDERAL RESERVE SYSTEM

12 CFR Part 248

[Docket No. R–1694]

RIN 7100–AF70

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 351

RIN 3064–AF17

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 75

RIN 3038–AE93

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 255

[Release No. BHCA–8; File No. S7–02–20]

RIN 3235–AM70

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 email, 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, 9 a.m.–5 p.m. ET or email *regulations@erulemakinghelpdesk.com.*

- *Email: 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, email 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, 9 a.m.–5 p.m. ET or email *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. R–1694; RIN 7100–AF70, 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.*
- *Email: 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 website 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 3064–AF17 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.
- *Email: comments@FDIC.gov.* Include the 3064–AF17 on the subject line of the message.
- *Public Inspection:* All comments received must include the agency name and RIN 3064–AF17 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.

CFTC: You may submit comments, identified by RIN 3038–AE93 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 website 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.

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 email to *rule-comments@sec.gov.* Please include File Number S7–02–20 on the subject line.

Paper Comments

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

All submissions should refer to File Number S7–02–20. 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.

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.

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.

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.

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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 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 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

[1] 12 U.S.C. 1851.

[2] *Id.*

[3] 12 U.S.C. 1851(d)(1).

[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).

[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 February 28, 2020 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/bankinforeg/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_*

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 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.

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 expansive [16] 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.

[12] 83 FR 33444–33446.

[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.

[16] *See* 79 FR 5677.

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 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.G (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 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 entity [20] 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 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]

[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*.

[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.

[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.

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 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.

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 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

[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.*

[26] *See, e.g.,* EBF and IIB.

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

[28] BVI.

[29] Data Boiler.

[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).

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]

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. 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 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

[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).

[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.*

[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.

[43] *Id.*

[44] *See, e.g.,* IIB.

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 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. 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

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

[46] 79 FR 5678–79.

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 ''[n]othing 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]

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.

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 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'

[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.

[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).

[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.

[60] 79 FR 5687.

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 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 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 in the business of making public welfare investments would result in banking entities being able to provide

[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.

[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.

[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).

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 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 the covered fund provisions in 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 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(l) 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 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

[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).

[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 CFR 208.22.

[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.

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

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 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 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 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 exclusions [93] and are

[79] *See* 2013 rule § __.10(c)(11).

[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.

[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).

[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

Continued

proposing an exclusion for credit funds. A 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]

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:

- 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 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 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

unable to satisfy the conditions of the loan securitization exclusion because credit funds do not typically issue asset-backed securities, credit 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).

[98] Proposed rule § __.10(c)(15)(i)(C)(*1*)(*iii*).

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

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

[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).

[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).

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 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 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]

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(*l*)–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

[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).

[112] *See* Financial Stability Oversight Counsel, 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%20rg.pdf.* (FSOC Report).

[113] *See id.*

[114] *See id.*

[115] *See id.*

[116] *See* 76 FR 68915.

[117] *See* 79 FR 5703–04.

[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.''

[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.*

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 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
- 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 advisor to the issuer, the banking entity would be required to:

- Provide in writing to any prospective and actual investor the disclosures required under § __.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 fund[136] 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
- 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 Act . . . .[137]

''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 portfolio company'' reflect the typical characteristics of investments made by venture capital funds and that these

[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).

[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.

[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).

[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).

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 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.

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.

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

[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 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.

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

[147] *See* Treasury Report at 77 and FSOC Report at 6.

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 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]

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 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:

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

[148] *See supra* note 110.

[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).

[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.*

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 §§ __.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 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]

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[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.

[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.

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 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 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]

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 fund; [164] (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 regulations. In addition, these proposed conditions are based on existing conditions in other provisions of the implementing regulations,[165] which the

[159] *See id.*

[160] *See e.g.,* BPI and SIFMA.

[161] *See* 83 FR 33471; 79 FR 5670–71.

[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.

[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.

[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

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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 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

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).

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 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 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 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

[166] *See* SIFMA; FSF; and ABA.

[167] *See* SIFMA and FSF.

[168] *See* ABA.

[169] *See* BPI.

[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).

[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.

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 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 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

[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 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).

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 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 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 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

[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 Public Law 111.203, section 608 (July 21, 2010). Section 13(f) of the BHC Act does not alter the applicability of 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).

[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).

[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

Continued

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 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, 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 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]

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

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.

[195] *See, e.g.,* BPI and FSF.

[196] *See* Public Citizen.

[197] *See, e.g.,* BPI; CS; and IAA.

[198] *Id.*

[199] *See, e.g.,* SIFMA.

[200] *See* 79 FR 5746.

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

[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.

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 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 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?

Question 74. Should the agencies impose any additional or different qualitative or quantitative limits on the

[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.

[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.

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

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 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 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 contractual rights to participate in the selection or removal of a general partner, managing member or

[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).

[212] 2013 rule § __.10(d)(6)(i).

[213] 83 FR 33481.

[214] *Id.*

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

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 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 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 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

[216] *See* SFIG.

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

[218] *See, e.g.,* ABA and CAE.

[219] *See* SFIG.

[220] *See* Data Boiler.

[221] *See* SFIG.

[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).

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. 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

[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.*

[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).

to adopt this parallel investment provision, the 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 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 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, 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 interest in his or her personal capacity in a covered fund sponsored by the banking entity if the

[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).

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

[243] 79 FR 5734.

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

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 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

[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).

''contractual obligation'' in the Conformance Rule? [246] Why or why not?

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?*
- *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?*

[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).

[247] Public Law 106–102, 113 Stat. 1338, 1471, 12 U.S.C. 4809.

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 or 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 *oira_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: 175 hours.

Estimated annual burden hours: 3,288 hours (1,759 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 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 of number of small entities.

The Board welcomes comment on all aspects of its analysis. In particular, the

[248] 5 U.S.C. 601 *et seq.*

[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).

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. 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.

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 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.

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

[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).

[252] Public Law 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.

[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.*

[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.

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

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 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. 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 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.

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,

[258] Public Law 115–174, May 24, 2018. *https://www.congress.gov/bill/115th-congress/senate-bill/2155.*

[259] Call Report data, June 2019.

[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.

[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).

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 U.S.C. 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

1. Broad Economic Considerations

a. Background

Section 13 of the Bank Holding Company (BHC) Act generally prohibits banking entities from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with, a hedge fund or private equity fund (covered funds), subject to certain exemptions. Section 13(h)(1) of the BHC Act defines the term ''banking entity'' to include (i) any insured depository institution (as defined by statute), (ii) any company that controls an insured depository institution, (iii) any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and (iv) any affiliate or subsidiary of such an entity.[266] In addition, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), enacted on May 24, 2018, amended section 13 of the BHC Act to exclude from the definition of ''insured depository institution'' any institution that does not have and is not controlled by a company that has (1) more than $10 billion in total consolidated assets; and (2) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5% of total consolidated assets.[267]

Certain SEC-regulated entities, such as broker-dealers, security-based swap dealers (SBSDs), and registered investment advisers (RIAs) affiliated with an insured depository institution, fall under the definition of ''banking entity'' and are subject to the prohibitions of section 13 of the BHC Act.[268] This economic analysis is limited to areas within the scope of the SEC's function as the primary securities markets regulator in the United States. In particular, the SEC's economic analysis focuses primarily on the potential effects of the proposed rule on (1) SEC registrants, in their capacity as such, (2) the functioning and efficiency of the securities markets, (3) investor protection, and (4) capital formation. SEC registrants that may be affected by the proposed rule include SEC-registered broker-dealers, SBSDs, and RIAs. Thus, the below analysis does not consider the direct effects on broker-dealers, SBSDs, and investment advisers that are not banking entities, or banking entities that are not SEC registrants, in either case for purposes of section 13 of the BHC Act. Potential spillover effects on these and other entities are, on a general basis, reflected in the analysis of effects on efficiency, competition, investor protection, and capital formation in securities markets. This economic analysis also discusses the impacts of the proposal on private funds,[269] to the degree that such

[265] 2 U.S.C. 1531 *et seq.*

[266] *See* 12 U.S.C. 1851(h)(1).

[267] These and other aspects of the regulatory baseline against which the SEC is assessing the economic effects of the proposed amendments on SEC-regulated entities are discussed in the economic baseline. On July 22, 2019, the agencies adopted a final rule amending the definition of ''insured depository institution'' in a manner consistent with EGRRCPA. *See* Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 84 FR 35008 (July 22, 2019) (''EGRRCPA Conforming Amendments Adopting Release''). In November 2019, the agencies adopted final rules tailoring certain proprietary trading and covered fund restrictions of the 2013 rule. *See* 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) (''2019 amendments'').

[268] Throughout this economic analysis, the terms ''banking entity'' and ''entity'' generally refer only to banking entities for which the SEC is the primary financial regulatory agency. While section 13 of the BHC Act and its associated rules apply to a broader set of banking entities, this economic analysis is limited to those banking entities for which the SEC is the primary financial regulatory agency as defined in section 2(12)(B) of the Dodd-Frank Act. *See* 12 U.S.C. 1851(b)(2), and 5301(12)(B).

Compliance with SBSD registration requirements is not yet required and there are currently no registered SBSDs. However, the SEC has previously estimated that as many as 50 entities may potentially register as SBSDs and that as many as 16 of these entities may already be SEC-registered broker-dealers. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, 84 FR 43872 (Aug. 22, 2019) (''Capital, Margin, and Segregation Adopting Release'').

For the purposes of this economic analysis, the term ''dealer'' generally refers to SEC-registered broker-dealers and SBSDs.

[269] There is significant overlap between the definitions of ''private fund'' and ''covered fund.'' For purposes of this economic analysis, ''private fund'' means 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(a)), but for section 3(c)(1) or section 3(c)(7) of that Act (15 U.S.C. 80a–3(c)(1) or (7)). 15 U.S.C. 80b–2(a)(29). Section 13(h)(2) of the BHC Act defines ''hedge fund'' and ''private equity fund'' to mean an issuer that would be an investment company, but for section 3(c)(1) or 3(c)(7) of the Investment Company Act, or ''such similar funds'' as the agencies determine by rule (*see* 12 U.S.C. 1851(h)(2)). In the

Continued

impacts may flow through to SEC registrants, such as RIAs, SEC-registered broker-dealers and SBSDs, and securities markets and investors.

In this proposal, the SEC is soliciting comment on all aspects of the costs and benefits associated with the proposed amendments for SEC registrants, including spillover effects the proposed amendments may have on efficiency, competition, and capital formation in securities markets.

In implementing section 13 of the BHC Act, the agencies sought to increase the safety and soundness of banking entities, promote financial stability, and reduce conflicts of interest between banking entities and their customers.[270] The regulatory regime created by the 2013 rule may have enhanced regulatory oversight and compliance with the substantive prohibitions of section 13 of the BHC Act, but could also have impacted capital formation and liquidity, as well as the provision by banking entities of a variety of financial services for customers.

Section 13 of the BHC Act also provides a number of statutory exemptions to the general prohibitions on proprietary trading and covered funds activities. For example, the statute exempts certain covered funds activities, such as organizing and offering covered funds.[271] The 2013 rule implemented these exemptions.[272] Banking entities engaged in activities and investments covered by section 13 of the BHC Act and the 2013 rule are required to establish a compliance program reasonably designed to ensure and monitor compliance with the 2013 rule.[273]

b. Broad Economic Effects

Certain aspects of the implementing regulations may have resulted in a complex and costly compliance regime that is unduly restrictive and burdensome on some affected banking entities.[274] Distinguishing between permissible and prohibited activities may be complex and costly, resulting in uncertain determinations for some entities. Moreover, the 2013 rule may have included in its scope some groups of market participants that do not necessarily engage in the activities or pose the risks that section 13 of the BHC Act intended to address. For example, the 2013 rule's definition of the term ''covered fund'' may include entities that do not engage in the activities contemplated by section 13 of the BHC Act or may include entities that do not pose the risks that section 13 is intended to mitigate.

The proposed amendments include amendments that reduce the scope of entities that may be treated as covered funds (*e.g.,* credit funds, venture capital funds, family wealth management vehicles, and customer facilitation vehicles), those that modify existing covered fund exclusions under the 2013 rule (*e.g.,* foreign public funds and small business investment companies),[275] and those that affect the types of permitted activities between certain banking entities and certain covered funds (*e.g.,* restrictions on relationships between banking entities and covered funds, definition of ''ownership interest,'' and treatment of loan securitizations). The proposed amendments would also reduce the burden on affected banking entities by addressing certain interpretations (*e.g.,* the treatment as ''banking entities'' of certain foreign excluded funds and the attribution to a banking entity, in certain circumstances, of investments made by the banking entity alongside a covered fund).

Broadly, to the extent that the proposed amendments directly change the scope of permissible covered fund activities, and indirectly reduce costs to banking entities and covered funds by reducing uncertainty regarding the scope of permissible activities, the proposed amendments may impact the economic effects of the 2013 rule as amended in 2019.[276] The SEC's economic analysis continues to recognize that the overall risk exposure of banking entities may generally arise out of a combination of activities, including proprietary trading, market making, traditional banking, asset management and investment activities, as well as the volume and structure in which banking entities engage in such activities, including the extent to which banking entities engage in hedging and other risk-mitigating activities. As discussed elsewhere,[277] the SEC recognizes the complex baseline effects of section 13 of the BHC Act, as amended by sections 203 and 204 of EGRRCPA, and the implementing regulations, on overall levels and structure of banking entity risk exposures.

The proposed amendments may benefit the functioning of the broader capital markets through, for example, increased ability and willingness of banking entities to facilitate capital formation through sponsorship and participation in certain types of funds and to transact with certain groups of counterparties.[278] For example, exclusions from the ''covered fund'' definition of specific types of entities may benefit banking entities by providing clarity and removing certain constraints around potentially profitable business opportunities and by reducing compliance costs, and may benefit excluded funds and their banking entity sponsors and advisers by increasing the spectrum of available counterparties and improving the quality or cost of financial services available to customers.

The proposed changes, however, may also facilitate risk-taking activities of banking entities. They also may change aspects of the relationships among banking entities and certain other

2013 rule, the agencies combined the definitions of ''hedge fund'' and ''private equity fund'' into a single definition ''covered fund'' (as in the statute) and defined this term to include any issuer that would be an investment company as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act with a number of express exclusions and additions as determined by the agencies (*See* 2013 rule § __.10(c)).

[270] *See, e.g.,* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 FR 5536, 5541, 5574, 5659, 5666 (Jan. 31, 2014) (''2013 rule adopting release''). An extensive body of research has examined moral hazard arising out of federal deposit insurance, implicit bailout guarantees, and systemic risk issues. *See, e.g.,* Andrew G. Atkeson et al., *Government Guarantees and the Valuation of American Banks,* 33 NBER Macroeconomics Ann. 81 (2018). *See also* Javier Bianchi, *Efficient Bailouts?,* 106 Amer. Econ. Rev. 3607 (2016); Bryan Kelly, Hanno Lustig, & Stijn Van Nieuwerburgh, *Too-Systematic-to-Fail: What Option Markets Imply about Sector-Wide Government Guarantees,* 106 Amer. Econ. Rev. 1278 (2016); Deniz Anginer, Asli Demirguc-Kunt, & Min Zhu, *How Does Deposit Insurance Affect Bank Risk? Evidence from the Recent Crisis,* 48 J. Banking & Fin. 312 (2014); Andrea Beltratti & Rene M. Stulz, *The Credit Crisis Around the Globe: Why Did Some Banks Perform Better?,* 105 J. Fin. Econ. 1 (2012); Pietro Veronesi & Luigi Zingales, *Paulson's Gift,* 97 J. Fin. Econ. 339 (2010). For a literature review, *see, e.g.,* Sylvain Benoit et al., *Where the Risks Lie: A Survey on Systemic Risk,* 21 Rev. Fin. 109 (2017).

[271] *See* section 13(d)(1)(G) of the BHC Act.

[272] *See* 2013 rule §§ __.4, __.5, __.6, __.11, __.13.

[273] *See* 2013 rule § __.20. *See also* 2019 amendments at 62021–25 which, among other things, modified these requirements for banking entities with limited trading assets and liabilities. Banking entities with limited trading assets and liabilities are presumed to be in compliance with the proposal and would have had no obligation to demonstrate compliance with subpart B and subpart C of the implementing regulations on an ongoing basis.

[274] This SEC Economic Analysis follows earlier sections by referring to the regulations implementing section 13 of the BHC Act that are effective as of February 28, 2020 as the ''implementing regulations''. *See supra* note 8.

[275] Although no amendment is currently proposed, the agencies are soliciting comment on modifying the covered fund exclusion for certain other types of entities (*e.g.,* public welfare funds). *See infra* section IV.F.3.a.

[276] *See, e.g.,* 2019 amendments at 62037–92.

[277] *See* id.

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

groups of market participants, including potentially introducing new conflicts of interest and increasing or reducing the potential effects of existing conflicts of interest. To the degree that some banking entities may react to the proposed amendments by restructuring activities involving covered funds to take advantage of the proposed exclusions, there may be shifts in the structure and levels of activities of banking entities involving risk. However, each of the proposed exclusions includes a number of conditions that are aimed at facilitating banking entity compliance while also allowing for customer oriented financial services provided on arms-length, market terms, and preventing evasion of the requirements of section 13.

Moreover, many of the proposed exclusions, such as for credit funds and venture capital funds, would allow banking entities to engage indirectly through fund structures in the same activities in which they are currently permitted to engage directly (*e.g.,* extensions of credit or direct ownership stakes). Other exclusions would permit banking entities to provide traditional banking and asset management services to customers through a legal entity structure, with conditions (*e.g.,* limitation on ownership by the banking entity and prohibition on ''bail outs'') intended to ensure that the risks that section 13 of the BHC Act was intended to address are mitigated. Finally, nothing in the proposal removes or modifies prudential capital, margin, and liquidity requirements that are applicable to banking entities and that facilitate the safety and soundness of banking entities and the financial stability of the United States.

The proposed amendments may also impact competition, allocative efficiency, and capital formation. To the extent that the implementing regulations are currently constraining banking entities in their covered fund activities, including providing traditional banking and asset management services to customers through a legal entity structure, the proposed exclusions from the definition of ''covered fund'' may increase competition between banking entities and other entities providing services to and otherwise transacting with those types of funds and other entities. Such competition may reduce costs or increase the quality of certain financial services provided to such funds and their counterparties.

Finally, the magnitude of the proposal's costs, benefits, and effects on efficiency, competition, and capital formation is influenced by a variety of factors, including the prevailing macroeconomic conditions, the financial condition of firms seeking to raise capital and of funds seeking to transact with banking entities, competition between bank and non-bank providers of capital, and many others. Moreover, the relative efficiency between fund structures and the direct provision of capital is likely to vary widely among banking entities and funds. The SEC recognizes that the economic effects of the proposed amendments may be dampened or magnified in different phases of the macroeconomic cycle, depend on monetary and fiscal policy developments and other government actions, and vary across different types of banking entities.

The SEC also considered the implications for investors of the proposed amendments. Broadly, the proposed amendments should increase the number of funds and other entities that will be excluded from the covered fund definition. This is likely to result in an increase in offerings of such funds or an increase in banking entities providing services to customers through entities such as client facilitation vehicles and family wealth management vehicles. The ability of investors to access public and private markets through funds and other entities may relax constraints on their portfolio optimization and, thus, enhance the efficiency of their portfolio allocations. The ability of additional investors to access these markets through funds and other entities may also benefit the issuers of the securities held by those funds and other entities by potentially increasing demand for those securities. Increased demand typically results in increased liquidity which can be important to investors as it may enable investors to exit (in a timely manner and at an acceptable price) from their positions in fund instruments, products, and portfolios.

Moreover, investors that seek access to public markets or other markets through foreign public funds may benefit to the extent the proposed amendments would result in banking entities offering more foreign public funds or offering these funds at a lower cost. Further, investors that prefer to implement a trading or investing strategy through a legal entity structure may benefit from the proposed amendments, which would allow banking entities to implement or facilitate such trading or investing strategy while providing other banking and asset management services to the investor. At the same time, higher risk exposures of banking entities sponsoring or investing in more funds that would be excluded from the covered fund provisions by the proposed amendments could adversely affect markets through the impact on financial stability and, therefore, investors. Any such potential effects are expected to be mitigated by the various conditions of the proposed exclusions from the definition of covered fund. For example, the proposed amendments would permit the banking entity to sponsor or invest in certain excluded funds (*e.g.,* credit funds or qualifying venture capital funds) only to the extent the banking entity ensures that the activities of the fund are consistent with safety and soundness standards that are substantially similar to those that would apply if the banking entity engaged in the activities directly. These and other conditions of the proposed exclusions are discussed in greater detail below.

c. Analytical Approach

The SEC's economic analysis is informed by research [279] on the effects of section 13 of the BHC Act and the 2013 rule, comments received by the agencies from a variety of interested parties, and experience administering the 2013 rule since its adoption. Throughout this economic analysis, the SEC discusses how different market participants [280] may respond to various aspects of the proposed amendments. This analysis also considers the potential effects of the proposed amendments on activities by banking entities that involve risk, their willingness and ability to engage in client-facilitation activities, and competition, market quality, and capital formation.

The proposed amendments would tailor, remove, or alter the scope of various covered fund requirements in the 2013 rule. Since section 13 of the BHC Act and the 2013 rule impose a number of different requirements, and, as discussed above, the type and level of risk exposure of a banking entity is the result of a combination of activities,[281] it is difficult to attribute the observed effects to a specific

[279] *See* 2019 amendments at 62044–54.

[280] The SEC's economic analysis is focused on the potential effects of the proposed rule on SEC registrants, the functioning and efficiency of the securities markets, investor protection, and capital formation. Thus, the below analysis does not consider broker-dealers or investment advisers that are not banking entities, or banking entities that are not SEC registrants, in either case for purposes of section 13 of the BHC Act, beyond the potential spillover effects on these entities and effects on efficiency, competition, investor protection, and capital formation in securities markets. *See infra* section IV.F.2.b.

[281] *See, e.g.,* 2013 rule adopting release at 5541.

provision or subset of requirements. In addition, analysis of the effects of the implementation of the 2013 rule is confounded by macroeconomic factors, other policy interventions, and post-crisis changes to market participants' risk aversion and return expectations. Because of the extended timeline of implementation of section 13 of the BHC Act and the overlap of the period during which the 2013 rule was in effect with other post-crisis changes affecting the same group or certain sub-groups of SEC registrants, the SEC cannot rely on frequently utilized quantitative methods that might otherwise enable causal attribution and quantification of the effects of section 13 of the BHC Act and the 2013 rule on measures of capital formation, liquidity, competition, and informational or allocative efficiency. Moreover, empirical measures of capital formation or liquidity are substantially limited by the fact that they do not provide insight into security issuance and transaction activity that does not occur as a result of the 2013 rule. Accordingly, it is difficult to quantify the primary security issuance and secondary market liquidity that would have been observed following the financial crisis absent various provisions of section 13 of the BHC Act and the 2013 rule.

Importantly, the existing securities markets—including market participants, their business models, market structure, etc.—differ in significant ways from the securities markets that existed prior to enactment of section 13 of the BHC Act and the implementation of the 2013 rule. For example, the role of dealers in intermediating trading activity has changed in important ways, including the following: (1) In recent years, on both an absolute and relative basis, bank dealers generally committed less capital to intermediation activities while non-bank dealers generally committed more, although not always in the same manner or on the same terms as bank dealers; (2) the volume and profitability of certain trading activities after the financial crisis may have decreased for bank dealers while it may have increased for other intermediaries, including non-bank entities that provide intraday liquidity, but generally not overnight liquidity, using sophisticated electronic trading algorithms and high speed access to data and trading venues; and (3) the introduction of alternative credit markets, including non-bank direct lending markets, may have contributed to liquidity fragmentation across markets while potentially increasing access to capital.[282]

Where possible, the SEC has attempted to quantify the costs and benefits expected to result from the proposed amendments. In many cases, however, the SEC is unable to quantify these potential economic effects. Some of the primary economic effects, such as the effect on incentives that may give rise to conflicts of interest in various regulated entities and the degree to which the 2013 rule may be impeding activity of banking entities with respect to certain investment vehicles, are inherently difficult to quantify. Moreover, some of the benefits of the 2013 rule's definitions and prohibitions that the agencies propose to amend, such as the potential benefits for resilience during a crisis or periods of market stress, are less readily observable under strong economic conditions, particularly when markets are less volatile and are functioning well. Further, it is difficult to quantify the net economic effects of any individual proposed amendment because of overlapping implementation periods of various post-crisis regulations affecting the same group of SEC registrants, the long implementation timeline of the 2013 rule and the implementing regulations, and the fact that many market participants changed their behavior in anticipation of future changes in regulation.

In some instances, the SEC lacks the information or data necessary to provide reasonable estimates for the economic effects of the proposed amendments. For example, the SEC lacks information and data on how market participants may choose to restructure their relationships with various types of entities in response to the proposed amendments; the amount of capital formation in covered funds that does not occur because of current covered fund provisions, including those concerning the definition of covered fund, restrictions on relationships with covered funds, the definition of ownership interest, and the exclusion for loan securitizations; the volume of loans, guarantees, securities lending, and derivatives activity dealers may wish to engage in with related covered funds; as well as the extent of risk reduction associated with the covered fund provision of the 2013 rule. Where the SEC cannot quantify the relevant economic effects, they are discussed in qualitative terms.

[282] *See* U.S Sec. & Exch. Comm'n, Access to Capital and Market Liquidity (Aug. 2017) (''SEC Report 2017'').

2. Economic Baseline

In the context of this economic analysis, the economic costs and benefits, and the impact of the proposed amendments on efficiency, competition, and capital formation, are considered relative to a baseline that includes the 2013 rule; the 2019 amendments; legislative amendments in EGRRCPA [283] and conforming amendments to the implementing regulations, as applicable; and current practices aimed at compliance with these regulations.

a. Regulation

The economic baseline against which the SEC is assessing the economic impact of the proposed amendments includes the legal and regulatory framework as it exists at the time of this release. Thus, the regulatory baseline for the SEC's economic analysis includes section 13 of the BHC Act as amended by EGRRCPA, and the 2013 rule. Further, the baseline accounts for the fact that since the adoption of the 2013 rule, the agencies have adopted the 2019 amendments, which, among other things, related to the ability of banking entities to engage in certain activities, including underwriting, market-making, and risk-mitigating hedging, with respect to ownership interests in covered funds, as well as amendments conforming the 2013 rule to Sections 203 and 204 of EGRRCPA. In addition, the staffs of the agencies have provided FAQ responses related to the regulatory obligations of banking entities, including SEC-regulated entities that are also banking entities under the 2013 rule, which likely influenced these entities' decisions about how to comply with the 2013 rule.[284] The Federal banking agencies also issued policy statements in 2017 and 2019 with respect to foreign excluded funds.[285]

Although the 2013 rule also included restrictions on proprietary trading and compliance requirements (as modified by the 2019 amendments), the most relevant portion of the 2013 rule for establishing an economic baseline is that involving covered fund restrictions.[286] The features of the regulatory framework under the 2013 rule most relevant to the baseline include the definition of the term

[283] *See supra* note 267.

[284] *See* id.

[285] *See, e.g.,* Board of Governors of the Federal Reserve System, 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* (''2019 Policy Statement'').

[286] *See* 2019 amendments at 61974.

''covered fund''; restrictions on a banking entity's relationships with covered funds; and restrictions on parallel investment, co-investment, and investments in the fund by banking entity employees.

Scope of the Covered Fund Definition

The definition of ''covered fund'' impacts the scope of the substantive prohibitions on banking entities acquiring or retaining an ownership interest in, sponsoring, and having certain relationships with, covered funds. The covered fund provisions of the 2013 rule may reduce the ability and incentives of banking entities to bail out affiliated funds to mitigate reputational risk, limit conflicts of interest with clients, customers, and counterparties, and reduce the ability of banking entities to engage in proprietary trading indirectly through funds. The 2013 rule defines covered funds, in part, as issuers that would be investment companies but for section 3(c)(1) or 3(c)(7) of the Investment Company Act and then excludes specific types of entities from the definition. The definition also includes certain commodity pools as well as certain foreign funds. Funds that rely on the exclusions in sections 3(c)(1) or 3(c)(7) of the Investment Company Act are covered funds unless an exclusion from the covered fund definition is available. Funds that rely on any exclusion or exemption from the definition of ''investment company'' under the Investment Company Act, other than the exclusion contained in section 3(c)(1) or 3(c)(7), such as real estate and mortgage funds that rely on the exclusion in section 3(c)(5)(C), are not covered funds under the 2013 rule.[287]

The broad definition of covered funds encompasses many different types of vehicles, and the 2013 rule excludes some of them from the definition of a covered fund.[288] The excluded fund types relevant to the baseline are funds that are regulated by the SEC under the Investment Company Act: RICs and BDCs. Seeding vehicles for these funds are also excluded from the covered fund definition during their seeding period.[289]

Restrictions on Relationships Between Banking Entities and Covered Funds

Under the baseline, banking entities are limited in the types of transactions in which they are able to engage with covered funds with which they have certain relationships. Banking entities that serve, directly or indirectly, as the investment manager, adviser, or sponsor to a covered fund are prohibited from engaging in a ''covered transaction,'' as defined in section 23A of the Federal Reserve Act, with the covered fund or with any other covered fund that is controlled by such covered fund.[290] Similarly, a banking entity that organizes and offers a covered fund pursuant to § __.11 or that continues to hold an ownership interest in a covered fund in accordance with § __.11(b) is prohibited from engaging in such a ''covered transaction.'' This prohibits all ''covered transactions'' that cause the banking entity to have credit exposure to the affiliated covered fund, including short-term extensions of credit, and various other transactions required for a banking entity to provide an affiliated covered fund payment, clearing, and settlement services.

Definition of ''Banking Entity''

For foreign banking entities,[291] certain funds organized under foreign law and offered to foreign investors (''foreign excluded funds'') are not ''covered funds'' under the 2013 rule, but may be subject to the 2013 rule as ''banking entities'' under certain circumstances. The banking agencies (in consultation with the staffs of the SEC and the CFTC) have provided temporary relief for qualifying foreign excluded funds that will expire in July 2021.[292]

Definition of ''Ownership Interest''

The 2013 rule prohibits a banking entity, as principal, from directly or indirectly acquiring or retaining an ''ownership interest'' in a covered fund.[293] The 2013 rule defines an ''ownership interest'' in a covered fund to mean any equity, partnership, or other similar interest. Under the 2013 rule, ''other similar interest'' is defined as 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);

(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 above.[294]

The 2013 rule permits a banking entity to acquire and retain an ownership interest in a covered fund that the banking entity organizes and offers pursuant to section __.11, but limits such ownership interests to three percent of the total number or value of the outstanding ownership interests of such fund (the per-fund limit).[295]

[287] *See* 2013 rule § __.10(c)(12)(ii).

[288] The exclusions from the covered fund definition are set forth in § __.10(c) of the 2013 rule.

[289] *See* 2013 rule § __.10(c)(12) (i) and § __.10(c)(12)(iii).

[290] *See* 2013 rule § __.14(a).

[291] For purposes of this analysis, ''foreign banking entity'' has the same meaning as used in the 2019 Policy Statement, *i.e.,* 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.

[292] *See* 2019 Policy Statement. For purposes of the 2019 Policy Statement, a ''qualifying foreign excluded fund'' means, with respect to a foreign banking entity, 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) 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.

[293] 2013 rule § __.10(a).

[294] 2013 rule § __.10(d)(6)(i).

[295] 2013 rule § __.12(a) (1)(ii) and § __.12(a)(2)(ii)(A). The 2013 rule also requires that

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Loan Securitizations

As discussed above, section 13 of the BHC Act provides a rule of construction that explicitly allows the sale and securitization of loans as otherwise permitted by law.[296] Accordingly, the 2013 rule excludes from the covered fund definition entities that issue asset-backed securities and meet specified conditions, including that they hold only loans, certain rights and assets, and a small set of other financial instruments (permissible assets).[297] In addition, the baseline includes the FAQs issued by agencies' staff in June 2014 regarding the servicing asset provision of the loan securitization exclusion, as discussed in section III.B.2 above.

Public Welfare and SBIC Exclusions

Under the 2013 rule, issuers in the business of making 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),[298] are excluded from the covered fund definition. Similarly, the 2013 rule excludes from the covered fund definition small business investment companies (SBICs) and issuers that have received notice from the Small Business Administration to proceed to qualify for a license as a SBIC and for which the notice or license has not been revoked.[299]

Attribution of Certain Investments to a Banking Entity

As discussed above, the 2013 rule includes a per fund limit and aggregate fund limit on a banking entity's ownership of covered funds that the banking entity organizes and offers.[300] The preamble to the 2013 rule stated, ''[I]f a banking entity makes investments side by side in substantially the same positions as a 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.'' [301] The agencies also stated that a banking entity that sponsors a covered fund should not make any additional side-by-side co-investment with the covered fund in a privately negotiated investment unless the value of such co-investment is less than 3% of the value of the total amount co-invested by other investors in such investment.[302] The 2019 amendments eliminated the aggregate fund limit and capital deduction requirement under § __.12(d) for the value of ownership interests in third-party covered funds (*e.g.,* covered funds that banking entities do not organize or offer), acquired or retained as a result of certain underwriting or market-making activities. However, the 2019 amendments did not change or amend the application of the per-fund limit or aggregate funds limit to co-investments alongside a covered fund.

For purposes of calculating the aggregate fund limit and capital deduction requirement, the 2013 rule requires attribution to a banking entity with respect to restricted profit interests in a covered fund for which the banking entity serves as investment manager, investment adviser, commodity trading advisor, or other service provider.[303] Under the 2013 rule, for purposes of calculating a banking entity's compliance with the aggregate fund limit and the capital deduction requirement, a 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.[304]

The sections that follow discuss rule provisions currently in effect, how each proposed amendment would change those provisions, and the anticipated costs and benefits of the proposed amendments, subject to the caveat that not all anticipated costs and benefits can be meaningfully quantified.

b. Affected Participants

The SEC-regulated entities directly affected by the proposed amendments include broker-dealers, security-based swap dealers, and investment advisers. The 2013 rule, as amended in 2019, imposed a range of restrictions and compliance obligations on banking entities with respect to their covered fund activities and investments. To the degree that the proposed amendments reduce or otherwise alter the scope of private funds subject to covered fund restrictions, SEC-registered banking entities, including broker-dealers, security-based swap dealers, and investment advisers may be affected by the proposal.

Broker-Dealers [305]

Under the 2013 rule, some of the largest SEC-regulated broker-dealers are banking entities. Table 1 reports the number, total assets, and holdings of broker-dealers affiliated with banks and broker-dealers that are not.

While the 3,504 domestic broker-dealers that are not affiliated with banks greatly outnumber the 198 banking entity broker-dealers subject to the 2013 rule, banking entity broker-dealers dominate non-banking entity broker-dealers in terms of total assets (73% of total broker-dealer assets) and aggregate holdings (68% of total broker-dealer holdings).

TABLE 1—BROKER-DEALER COUNT, ASSETS, AND HOLDINGS BY AFFILIATION

Broker-dealer affiliation	Number	Total assets, $mln [306]	Holdings, $mln [307]	Holdings (alternative), $mln [308]
Affected bank broker-dealers [309]	198	3,340,366	804,354	640,779
Non-bank broker-dealers [310]	3,504	1,242,246	385,137	218,777

the aggregate value of all ownership interests of a banking entity and its affiliates in all covered funds acquired or retained under § __.12 may not exceed three percent of the tier 1 capital of the banking entity. 2013 rule § __.12(a)(2)(iii) (the aggregate funds limit).

[296] 13 U.S.C. 1851(g)(2). *See supra* section III.B.2.

[297] *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. § __.2(t).

[298] *See* 2013 rule § __.10(c)(11)(ii).

[299] *See* 2013 rule § __.10(c)(11)(i).

[300] 2013 rule § __.12(a).

[301] 2013 rule adopting release at 5734.

[302] Id.

[303] 2013 rule § __.10(d)(6)(ii); § __.12(c)(1), (d); *See also* 12 U.S.C. 1851(d)(1)(G).

[304] 2013 rule § __.12(c)(1), (d).

[305] These estimates differ from those in the EGRRCPA Conforming Amendments Adopting Release, as these estimates rely on more recent data and information about both U.S. and global trading assets and liabilities of bank holding companies. This analysis is based on data from Reporting Form FR Y–9C for domestic holding companies on a consolidated basis and Report of Condition and Income for banks regulated by the Board, FDIC, and OCC for the most recent available four-quarter average, as well as data from S&P Market Intelligence LLC on the estimated amount of global trading activity of U.S. and non-U.S. bank holding companies. Broker-dealer bank affiliations were obtained from the Federal Financial Institutions Examination Council's (FFIEC) National Information Center (NIC). Broker-dealer assets and holdings were obtained from FOCUS Report data for Q3 2019.

TABLE 1—BROKER-DEALER COUNT, ASSETS, AND HOLDINGS BY AFFILIATION—Continued

Broker-dealer affiliation	Number	Total assets, $mln [306]	Holdings, $mln [307]	Holdings (alternative), $mln [308]
Total	3,702	4,582,612	1,189,491	859,556

Security-Based Swap Dealers

The proposed amendments may also affect bank-affiliated SBSDs. As compliance with SBSD registration requirements is not yet required, there are currently no registered SBSDs. However, the SEC has previously estimated that as many as 50 entities may potentially register with the SEC as security-based swap dealers and that as many as 16 may already be SEC-registered broker-dealers.[311] Given the analysis of DTCC Derivatives Repository Limited Trade Information Warehouse (''TIW'') transaction and positions data on single-name credit-default swaps and consistent with other recent SEC rulemakings, the SEC preliminarily believes that 41 entities that may register with the SEC as SBSDs are bank-affiliated firms, including those that are SEC-registered broker-dealers. Therefore, the SEC preliminarily estimates that, in addition to the bank-affiliated SBSDs that are already registered as broker-dealers and included in the discussion above, as many as 25 other bank-affiliated SBSDs may be affected by the proposed amendments.[312] Similarly, on the basis of the analysis of TIW data, the SEC estimates that none of the entities that may register with the SEC as Major Security-Based Swap Participants are affected by the final rule.

Importantly, because registration is not yet required, compliance with capital and other substantive requirements for SBSDs under Title VII of the Dodd-Frank Act is also not yet required.[313] The SEC recognizes that firms may choose to move security-based swap trading activity into (or out of) an affiliated bank or an affiliated broker-dealer instead of registering as a standalone SBSD if bank or broker-dealer capital and other regulatory requirements are less (or more) costly than those that may be imposed on SBSDs under Title VII. As a result, the above figures may overestimate or underestimate the number of SBSDs that are not broker-dealers and that may become SEC-registered entities affected by the proposed amendments.

Private Funds and Private Fund Advisers [314]

This section describes RIAs advising private funds that may be affected by the proposed amendments. Using Form ADV data, Table 2 reports the number of RIAs advising private funds by fund type, as those types are defined in Form ADV.[315] Private funds rely on either section 3(c)(1) or 3(c)(7) of the Investment Company Act and so meet the 2013 rule's definition of ''covered fund.'' Table 3 reports the number and gross assets of private funds advised by RIAs and separately reports these statistics for banking entity RIAs. As can be seen from Table 2, the two largest categories of private funds advised by RIAs are hedge funds and private equity funds.[316]

Banking entity RIAs advise a total of 4,274 private funds with approximately $1.97 trillion in gross assets. From Form ADV data, banking entity RIAs' gross private fund assets under management are concentrated in hedge funds and private equity funds. The SEC estimates on the basis of this data that banking entity RIAs advise 879 hedge funds with approximately $668 billion in gross assets and 1,430 private equity funds with approximately $397 billion in assets.

[306] Broker-dealer total assets are based on FOCUS report data for ''Total Assets.''

[307] Broker-dealer holdings are based on FOCUS report data for securities and spot commodities owned at market value, including bankers' acceptances, certificates of deposit and commercial paper, state and municipal government obligations, corporate obligations, stocks and warrants, options, arbitrage, other securities, U.S. and Canadian government obligations, and spot commodities.

[308] This alternative measure excludes U.S. and Canadian government obligations and spot commodities.

[309] This category includes all bank-affiliated broker-dealers except those exempted by section 203 of EGRRCPA.

[310] This category includes both bank affiliated broker-dealers subject to section 203 of EGRRCPA and broker-dealers that are not affiliated with banks or holding companies.

[311] *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers, 84 FR 68550, 68607 (Dec. 16, 2019) (''Recordkeeping and Reporting Adopting Release'').

[312] *See* id.

[313] *See* Capital, Margin, Segregation Adopting Release at 43954. *See also* Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, Exchange Act Release No. 34–87780 (Dec. 18, 2019) (''Cross Border Amendments Adopting Release'').

[314] These estimates are calculated from Form ADV data as of September 30, 2019. An investment adviser is defined as a ''private fund adviser'' for the purposes of this economic analysis if it indicates that it is an adviser to any private fund on Form ADV Item 7.B. An investment adviser is defined as a ''banking entity RIA'' if it indicates on Form ADV Item 6.A.(7) that it is actively engaged in business as a bank, or it indicates on Form ADV Item 7.A.(8) that it has a ''related person'' that is a banking or thrift institution. For purposes of Form ADV, a ''related person'' is any advisory affiliate and any person that is under common control with the adviser. The definition of ''control'' for purposes of Form ADV, which is used in identifying related persons on the form, differs from the definition of ''control'' under the BHC Act. In addition, this analysis does not exclude SEC-registered investment advisers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets. Those banks are no longer subject to the requirements of the 2013 rule following enactment of the EGRRCPA. Thus, these figures may overestimate or underestimate the number of banking entity RIAs.

[315] RIAs may also advise foreign public funds that are excluded from the covered fund definition in the 2013 rule, are the subject of proposed amendments discussed below, and are not reported on Form ADV.

[316] For purposes of Form ADV, ''private equity fund'' is defined as ''any private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund, or venture capital fund and does not provide investors with redemption rights in the ordinary course.'' *See* Form ADV: Instructions for Part 1A, Instruction 6. For purposes of Form ADV, ''hedge fund'' is defined as ''any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration).

[317] This table includes only the advisers that list private funds on Section 7.B.(1) of Form ADV. The number of advisers in the ''Any Private Fund'' row is not the sum of the rows that follow since an adviser may advise multiple types of private funds. Each listed private fund type (*e.g.,* real estate funds and liquidity funds) is defined in Form ADV, and those definitions are the same for purposes of the SEC's Form PF.

TABLE 2—SEC-REGISTERED INVESTMENT ADVISERS ADVISING PRIVATE FUNDS BY FUND TYPE [317]

Fund type	All RIA	Banking entity RIA
Hedge Funds	2,695	149
Private Equity Funds	1,707	96
Real Estate Funds	540	52
Securitized Asset Funds	226	44
Venture Capital Funds	207	8
Liquidity Funds	47	15
Other Private Funds	1,071	143
Total Private Fund Advisers	4,854	285

TABLE 3—THE NUMBER AND GROSS ASSETS OF PRIVATE FUNDS ADVISED BY SEC-REGISTERED INVESTMENT ADVISERS [318]

Fund type	Number of private funds		Gross assets, $bln	
	All RIA	Banking entity RIA	All RIA	Banking entity RIA
Hedge Funds	10,602	879	7,478	668
Private Equity Funds	15,144	1,430	3,541	397
Real Estate Funds	3,546	321	656	100
Securitized Asset Funds	1,836	355	674	131
Venture Capital Funds	1,286	43	158	3
Liquidity Funds	89	29	1,339	195
Other Private Funds	4,505	1,218	1,386	478
Total Private Funds	37,002	4,274	15,231	1,971

In addition, the SEC's economic analysis is informed by private fund statistics submitted by certain RIAs of private funds through Form PF as summarized in quarterly ''Private Fund Statistics.'' [319]

Registered Investment Companies and Business Development Companies

The baseline also reflects the potential that a registered investment company (RIC) or a business development company (BDC) would be treated as a banking entity where the RIC or BDC's sponsor is a banking entity that holds 25% or more of the RIC or BDC's voting securities after a seeding period.[320] On the basis of SEC filings and public data, the SEC estimates that, as of September 2019, there were approximately 15,500 RICs [321] and 106 BDCs. Although RICs and BDCs are generally not themselves banking entities subject to the 2013 rule, they may be indirectly affected by the 2013 rule and the proposed amendments, for example, if their sponsors or advisers are banking entities. For instance, bank-affiliated RIAs or their affiliates may reduce their level of investment in the RICs or BDCs they advise, or potentially close those funds, to eliminate the risk of those funds becoming banking entities themselves.

Small Business Investment Companies

Small business investment companies (SBICs) are generally ''privately owned and managed investment funds, licensed and regulated by the Small Business Administration (SBA), that use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses.'' [322] The proposed amendments would provide relief with respect to banking entity investments in SBICs during the wind-down process by excluding from the definition of ''covered fund'' those SBICs.[323] While the SEC does not have data to quantify the number of SBICs undergoing wind-down, trends in the number of SBIC licenses can be indicative of the turnover in the total number of SBIC licensees. For example, according to SBA data, there were 302 SBIC licensees as of June 30, 2019 [324] and 300 SBIC licensees as of September 30, 2019.[325] By contrast, as of June 30, 2017, there were 315 SBICs licensed by the SBA.[326]

[318] Gross assets include uncalled capital commitments on Form ADV.

[319] *See* U.S. Securities and Exchange Commission, Division of Investment Management Analytics Office, Private Fund Statistics, First Calendar Quarter 2019, (Oct. 25, 2019), *available at https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2019-q1.pdf.* Statistics for preceding quarters are *available at https://www.sec.gov/divisions/investment/private-funds-statistics.shtml.*

[320] *See, e.g.,* 2019 amendments at 61979.

[321] This estimate includes open-end companies, exchange-traded funds, closed-end funds, and non-insurance unit investment trusts and does not include fund of funds. The inclusion of fund of funds increases this estimate to approximately 17,000.

[322] *See* U.S. Small Business Administration, SBIC Program Overview, *available at https://www.sba.gov/content/sbic-program-overview.*

Pursuant to Advisers Act section 203(b)(7), an SBIC is (other than an entity that has elected to be regulated or is regulated as a business development company pursuant to section 54 of the Investment Company Act of 1940): (A) A small business investment company that is licensed under the Small Business Investment Act of 1958 (''SBIA''), (B) an entity that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company under the SBIA, which notice or license has not been revoked, or (C) an applicant that is affiliated with 1 or more licensed small business investment companies described in subparagraph (A) and that has applied for another license under the SBIA, which application remains pending.

[323] Specifically, the proposed amendments would exclude from the definition of ''covered fund'' any SBIC that has voluntarily surrendered its license to operate as an SBIC in accordance with 13 CFR 107.1900 and does not make any new investments (with some exceptions) after such voluntary surrender. Proposed rule § __.10(c)(11)(i).

[324] *See* U.S. Small Business Administration, SBIC Program Overview as of June 30, 2019, *available at https://www.sba.gov/sites/default/files/2019-09/SBIC%20Quarterly%20Report%20as%20of%20June_30_2019.pdf.*

[325] *See* U.S. Small Business Administration, SBIC Program Overview as of September 30, 2019, *available at https://www.sba.gov/sites/default/files/2019-11/SBIC%20Quarterly%20Report%20as%20of%20September_30_2019.pdf.*

[326] *See* U.S. Small Business Administration, SBIC Quarterly Report as of March, 31 2017, *available at*

The agencies are requesting comment on whether they should provide relief to rural business investment companies (''RBICs'') from the 2013 rule that is similar to the relief provided to SBICs.[327] As the SEC has discussed elsewhere,[328] an RBIC is defined in Section 384A of the Consolidated Farm and Rural Development Act as a company that is approved by the Secretary of Agriculture and that has entered into a participation agreement with the Secretary.[329] Because SBICs and RBICs share the common purpose of promoting capital formation in their respective sectors, advisers to SBICs and RBICs are treated similarly under the Advisers Act in that they have the opportunity to take advantage of expanded exemptions from investment adviser registration.[330] As of August 2019, there were 5 RBICs who were licensed by the USDA managing approximately $352 million in assets.[331]

The Tax Cuts and Jobs Act established the ''opportunity zone'' program to provide tax incentives for long-term investing in designated economically distressed communities.[332] 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.[333] In this regard, QOFs are similar to SBICs and public welfare companies. The agencies are requesting comment on whether they should provide relief to QOFs from the 2013 rule that is similar to the relief provided to SBICs.[334] SEC staff are not aware of an official source for data regarding QOFs that are available for investment, but some private firms collect and report such data. One such firm reports that, as of January 2020, there were 292 QOFs that report raising $6.72 billion in equity, and have a fundraising goal of $27.9 billion.[335]

3. Costs and Benefits

Section 13 of the BHC Act generally prohibits banking entities from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with covered funds, subject to certain exemptions.[336] The SEC's economic analysis concerns the potential costs, benefits, and effects on efficiency, competition, and capital formation of the proposed amendments for five groups of market participants. First, the proposed amendments may impact SEC-registered investment advisers that are banking entities, including those that sponsor or advise covered funds and those that do not, as well as SEC-registered investment advisers that are not banking entities that sponsor or advise covered funds and compete with banking entity RIAs. Second, the proposed amendments would permit dealers greater flexibility in providing services to more types of funds since dealers could provide a broader array of services to funds that would be excluded from the covered fund definition. Third, banking entities that are broker-dealers or RIAs may enjoy reduced uncertainty and greater flexibility with respect to direct investments they make alongside covered funds. Fourth, the proposed amendments may impact private funds and other vehicles, including those entities scoped in or out of the covered fund provisions of the 2013 rule, as well as private funds competing with such funds. One such impact may be seen to the extent that the proposed amendments permit banking entities to provide a full range of traditional customer-facing banking and asset management services to certain entities, such as customer facilitation vehicles and family wealth management vehicles. Fifth, to the extent that the proposed amendments impact efficiency, competition, and capital formation in covered funds or underlying securities, investors in, and sponsors of, covered funds and underlying securities and issuers may be affected as well.

As discussed below, careful consideration was given to the competing effects that could potentially result from the proposed amendments and alternatives. For example, the proposed amendments could result in enhanced competition among, and capital formation driven by, entities that would be treated as covered funds under the 2013 rule. The proposed amendments could also potentially increase (or decrease) moral hazard and other financial risks posed by investments in covered funds; however, the agencies have sought to mitigate the potential for increased risk and other concerns by imposing various conditions on the proposed exclusions designed to address such risks. To the extent that the current covered fund provisions limit fund formation, the proposed amendments and other amendments on which the agencies seek comment could provide greater ability for banking entities to organize funds and attract capital from third party investors, which could increase revenues for banking entities while reducing long-term compliance costs; increase the availability of venture, credit, and other financing, including for small businesses and start-ups; and, as a result, increase capital formation. The SEC is not currently aware of any information or data that would allow a quantification of the extent to which the covered fund provisions of the 2013 rule are inhibiting capital formation via funds. Therefore, the bulk of the analysis below is necessarily qualitative. To the extent that the current covered fund provisions limit alignment of interests between banking entities and their clients, customers, or counterparties, and to the extent the proposed amendments would alter the alignment of interests, the proposed amendments could have a positive or negative effect on conflict of interest concerns.

The proposed amendments create new recordkeeping requirements and revise certain disclosure requirements. Specifically, a banking entity may only rely on the exclusion for customer

https://www.sba.gov/sites/default/files/files/Quarterly_Data_as_of_March_31_2017_0.pdf.

[327] Under the implementing regulations, an SBIC is excluded from the ''covered fund'' definition. *See* 2013 rule § __.10(c)(11)(i).

[328] *See* Amending the ''Accredited Investor'' Definition, 85 FR 2574 (Jan. 15, 2020) (''Accredited Investor Definition Proposing Release'').

[329] *See* the RBIC Advisers Relief Act of 2018, Public Law 115–417 (2019) (the ''RBIC Advisers Relief Act''). To be eligible to participate as an RBIC, the company must be a newly formed for-profit entity or a newly formed for-profit subsidiary of such an entity, have a management team with experience in community development financing or relevant venture capital financing, and invest in enterprises that will create wealth and job opportunities in rural areas, with an emphasis on smaller enterprises. *See* 7 U.S.C. 2009cc–3(a).

[330] Following enactment of the RBIC Advisers Relief Act, advisers to solely RBICs and advisers to solely SBICs are exempt from investment adviser registration pursuant to Advisers Act Sections 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 proposed exclusion for certain venture capital funds discussed below (*see infra* text accompanying notes 380 and 381) which would require that a fund be a venture capital fund as defined in the SEC regulations implementing the registration exemption, could include RBICs and SBICs to the extent that they satisfy the other elements of the proposed exclusion.

[331] Rural Business Investment Company Applications filed with the USDA. To contact the USDA for data about Rural Business Investment Company Applications filed with the USDA *see https://www.rd.usda.gov/programs-services/rural-business-investment-program.*

[332] Tax Cuts and Jobs Act of 2017, Public Law 115–97, 131 Stat. 2054 (2017).

[333] *See* U.S. Securities and Exchange Commission and NASAA, Staff Statement on Opportunity Zones: Federal and State Securities Laws Considerations, *available at https://www.sec.gov/2019_Opportunity-Zones_FINAL_508v2.pdf (''Opportunity Zone Statement'').*

[334] *See supra* note 328.

[335] As reported by Novogradac, a national professional services organization that collects and reports information on QOFs. *See https://www.novoco.com/resource-centers/opportunity-zone-resource-center/opportunity-funds-listing.*

[336] *See* 12 U.S.C. 1851.

facilitation vehicles if the banking entity and its affiliates maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to a transaction, investment strategy or service offered by the banking entity. As discussed in section IV.B [337]and below, these new recordkeeping burdens may impose an initial burden of $1,078,650 [338] and an ongoing annual burden of $1,078,650.[339] In addition, under certain circumstances, a banking entity must make certain disclosures with respect to an excluded credit fund, venture capital fund, family wealth vehicle, or customer facilitation vehicle, as if the entity were a covered fund. As discussed in section IV.B, these disclosure requirements may impose an initial burden of $53,933 [340] and an ongoing burden of $1,402,245.[341]

a. Amendments Related to Specific Types of Funds

As discussed elsewhere in this **SUPPLEMENTARY INFORMATION**, the proposed amendments modify a number of the provisions of the 2013 rule related to the treatment of certain types of funds (*e.g.,* credit funds, family wealth management vehicles, small business investment companies, venture capital funds, customer facilitation vehicles, foreign excluded funds, foreign public funds, and loan securitizations).

Broadly, such modifications reduce the number and types of funds that are within the scope of the 2013 rule, impacting the economic effects of section 13 of the BHC Act and the 2013 rule.[342]

Form ADV data is not sufficiently granular to allow the SEC to estimate the number of funds and fund advisers affected by the different proposed exclusions from the covered fund definition and other relief on which the agencies are seeking comment. However, Table 2 and Table 3 in the economic baseline quantify the number and asset size of private funds advised by banking entity RIAs by the type of private fund they advise, as those fund types are defined in Form ADV.[343]

Using Form ADV data, the SEC preliminarily estimates that approximately 149 banking entity RIAs advise hedge funds and 96 banking entity RIAs advise private equity funds (as those terms are defined in Form ADV).[344] As can be seen from Table 2 in the economic baseline, 44 banking entity RIAs advise securitized asset funds. Table 3 shows that banking entity RIAs advise 355 securitized asset funds with $131 billion in gross assets. Another 52 banking entity RIAs advise real estate funds, and banking entity RIAs advise 321 real estate funds with $100 billion in gross assets. Venture capital funds are advised by only 8 banking entity RIAs, and all 43 venture capital funds advised by banking entity RIAs have in aggregate approximately $3 billion in gross assets.

As noted elsewhere in this **SUPPLEMENTARY INFORMATION**, the covered fund provisions of the 2013 rule may limit the ability of banking entities to use covered funds to circumvent the proprietary trading prohibition, reduce bank incentives to bail out their covered funds, and mitigate conflicts of interest between banking entities and their clients, customers, or counterparties. However, the covered fund definition is broad,[345] and some commenters have stated that the 2013 rule may limit the ability of banking entities to conduct traditional asset management activities and reduce the availability of capital to entrepreneurs and the market as a whole.[346] The covered fund provisions of the 2013 rule, as currently in effect, may impose significant costs on some banking entities.[347] The breadth of the covered fund definition requires market participants to review a large number of issuers to determine if they are covered funds as defined in the 2013 rule. For example, the SEC understands that this has included a review of hundreds of thousands of CUSIPs issued by common types of securitizations for covered fund status.[348] The need to perform an in-depth analysis and make covered funds determinations across a large number of entities involves costs and may adversely affect the willingness of banking entities to acquire or retain ownership interests in, sponsor, and have relationships with entities that may be treated as covered funds under the 2013 rule. Moreover, the 2013 rule's limitations on banking entities' investment in covered funds may be more significant for covered funds that are typically small in size, with potentially more negative spillover effects on capital formation in underlying securities.[349]

The proposed amendments could reduce the scope of funds that need to be analyzed for covered fund status or could simplify this analysis and enable banking entities to own, sponsor, and have relationships with the types of entities that the proposed amendments would exclude from the covered fund definition. Accordingly, the proposed amendments may reduce costs of banking entity ownership in, sponsorship of, and transactions with certain funds; may promote greater capital formation in, and competition among such funds; and may improve access to capital for issuers of underlying debt or equity that possibly will be purchased by those funds.

The proposed amendments may also benefit banking entity dealers through higher profits or greater demand for derivatives, margin, payment, clearing, and settlement services. Reducing

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[337] For the purposes of the burden estimates in this release, we are assuming the cost of $423 per hour for an attorney, from SIFMA's ''Management & Professional Earnings in the Securities Industry 2013,'' modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, and adjusted for inflation.

[338] In the 2019 amendments, amendments that sought, among other things, to provide greater clarity and certainty about what activities are prohibited by the 2013 rule—in particular, under the prohibition on proprietary trading—and to better tailor the compliance requirements based off of the risk of a banking entity's activities, banking entity PRA-related burdens were apportioned to SEC-regulated entities on the basis of the average weight of broker-dealer assets in holding company assets. *See* 2019 amendments at 62074. SEC staff preliminarily believe that such an approach would be inappropriate for the PRA-related burdens associated with the proposed amendments because we do not have a comparable proxy for an investment adviser's significance within the holding company. Since we do not have sufficient information to determine the extent to which the costs associated with any of the new recordkeeping and disclosure requirements would be borne by SEC registrants specifically, we report the entire burden estimated based on information in section IV.B.

Initial recordkeeping burdens: (10 hours) × (255 entities) × (Attorney at $423 per hour) = $1,078,650.

[339] Annual recordkeeping burdens: (10 hours) × (255 entities) × (Attorney at $423 per hour) = $1,078,650.

[340] Initial recordkeeping burdens: (0.5 hours) × (255 entities) × (Attorney at $423 per hour) = $53,933.

[341] Annual recordkeeping burdens: (0.5 hours) × (255 entities) × (26 disclosures per year) × (Attorney at $423 per hour) = $1,402,245.

[342] *See, e.g.,* 2019 amendments at 62037–92.

[343] These fund types include hedge funds, private equity funds, real estate funds, securitized asset funds, venture capital funds, liquidity, and other private funds. *See supra* note 317.

[344] As noted in the economic baseline, a single RIA may advise multiple types of funds. *See supra* note 318.

[345] *See, e.g.,* ABA; AAF; FSF; SIFMA; JBA.

[346] *See, e.g.,* AAF; Credit Suisse; JBA; NVCA; Chamber.

[347] *See, e.g.,* SIFMA; JBA; ACG; 10 Regional Banks; BPI; ICI; IIB; ABA; LTSA; SBIA; SFIG 2017.

[348] *See* comment letters responding to OCC Notice Seeking Public Input on the Volcker Rule (Aug. 2017), *available at https://www.regulations.gov/docketBrowser?rpp=25&so=DESC&sb=commentDueDate&po=0&dct=PS&D=OCC-2017-0014.* A summary of the comment letters is *available at https://occ.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-notice-comment-summary.pdf.*

[349] The median venture capital fund size in some locations is approximately $15 million. One fund may have lost as much as $50 million dollars in investment because of the prohibitions of section 13 of the BHC Act and implementing regulations. *See* NVCA.

restrictions on banking entities by further tailoring the covered fund definition may encourage more launches of funds that are excluded from the definition, capital formation and, possibly, competition in those types of funds. If competition increases the quality of funds available to investors or reduces the fees they are charged, investors in funds may benefit. Moreover, to the degree that the proposed amendments may increase the spectrum of funds available to investors, the proposal may relax constraints around investor portfolio optimization and increase the efficiency of capital allocation.

The sections that follow further discuss these possible overarching economic costs, benefits, and effects of competition, efficiency, and capital formation with respect to specific types of funds and proposed amendments.

Foreign Excluded Funds

Under the baseline, foreign excluded funds are excluded from the covered fund definition, but could be considered banking entities if a foreign banking entity controls the foreign fund in certain circumstances. As discussed above, the federal banking agencies released a policy statement on July 17, 2019, which provides that the federal banking agencies would not propose to take action during the two-year period ending on July 21, 2021 (i) against a foreign banking entity based on attribution of the activities and investments of a qualifying foreign excluded fund to the foreign banking entity [350] or (ii) against a qualifying foreign excluded fund as a banking entity, in each case where the foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, the qualifying foreign excluded fund would meet 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.[351] The proposed amendment would provide a permanent exemption from the proprietary trading and covered fund prohibitions for certain foreign excluded funds that is substantively similar to the temporary no-action relief currently provided to qualifying foreign excluded funds.[352]

The SEC recognizes that failing to exclude such funds from the definition of ''banking entity'' in the 2013 rule imposes proprietary trading restrictions, covered fund prohibitions, and compliance obligations on qualifying foreign excluded funds that may be more burdensome than the requirements that would apply under the 2013 rule to covered funds. The SEC has also received comment opposing carving out qualifying foreign excluded funds from the definition of banking entity.[353] The SEC preliminarily believes that, absent the proposed amendments and upon expiry of the temporary relief, the 2013 rule may have significant adverse effects on the ability of foreign banking entities to organize and offer certain private funds for foreign investments, disrupting foreign asset management activities. The SEC recognizes that the exemption of qualifying foreign excluded funds from the proprietary trading and covered fund prohibitions that apply to ''banking entities'' may result in increased activity by foreign banking entities in organizing and offering such funds, and that such activity may involve risk for those banking entities. At the same time, the SEC recognizes a statutory purpose of certain portions of section 13 of the BHC Act is to limit the extraterritorial impact on foreign banking entities.[354] Accordingly, the proposed amendments may benefit foreign banking entities and their foreign counterparties seeking to transact with and through such funds.

The proposed amendments may increase the incentive for some foreign banking entities seeking to organize and offer qualifying foreign excluded funds to reorganize their activities so that these funds' activities qualify for the proposed exemptions. The costs and feasibility of such reorganization will depend on the complexity and existing compliance structures for banking entities, the degree to which there is unmet demand for investment funds that may be organized as qualifying foreign excluded funds, and the profitability of such banking activities. Importantly, the principal risk of foreign banking entities' activities related to foreign excluded funds generally resides outside the United States and is unlikely to affect negatively the safety and soundness of U.S. banking entities or systemic risk to the U.S. financial system.

Foreign Public Funds

The 2013 rule excludes from the covered fund definition any foreign public fund that satisfies three sets of conditions. First, the issuer must be organized or established outside of the United States, be authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction (the ''home jurisdiction'' requirement), and sell ownership interests predominantly through one or more public offerings outside of the United States. Second, for funds that are sponsored by a U.S. banking entity, or by a banking entity controlled by a U.S. banking entity, the ownership interests in the issuer must be sold ''predominantly'' (the ''predominantly'' requirement) to persons other than the sponsoring banking entity, the issuer, their affiliates, directors of such entities, or employees of such entities (the employee sales limitation). Third, such public offerings must occur outside the United States, must comply with applicable jurisdictional requirements, may not restrict availability to investors having a minimum level of net worth or net investment assets, and must have publicly available offering disclosure documents filed or submitted with the relevant jurisdiction.

The proposed amendments would make five changes to the foreign public fund exclusion. First, the proposal would remove the home jurisdiction requirement.[355] Second, the proposal would make the exclusion available with respect to issuers authorized to offer and sell ownership interests through one or more public offerings, removing the requirement that the issuer sells ownership interests ''predominantly'' through such public offerings.[356] Third, the agencies are also proposing to modify the definition of ''public offering'' from the 2013 rule to add a new requirement that the distribution is subject to substantive disclosure and retail investor protection laws or regulations in one or more jurisdictions where ownership interests are sold.[357] Fourth, the proposal would apply the condition that the distribution comply with all applicable requirements in the jurisdiction where it is made only to instances in which the banking entity serves as the investment manager, investment adviser, commodity trading advisor, commodity pool operator, or

[350] Foreign banking entity was defined for purposes of the 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.

[351] *See* 2019 Policy Statement. This policy statement continued the position of the Federal banking agencies that was released on July 21, 2017, and the position that the agencies expressed in the 2018 proposal.

[352] *See* proposed rule §§ __.6(f) and __.13(d).

[353] *See* Data Boiler.

[354] *See supra* note 30 and the referencing paragraph.

[355] *See* proposed rule § __.10(c)(1)(i)(B).

[356] *See* proposed rule § __.10(c)(1)(i)(B).

[357] *See* proposed rule § __.10(c)(1)(iii)(A).

sponsor.[358] Finally, the proposal would narrow the employee sales limitation to senior executive officers as defined in section 225.71(c) of the Board's Regulation Y.[359]

The SEC has received comments indicating that the foreign public fund exclusion under the 2013 rule is impractical, overly narrow, and prescriptive, and results in competitive disparities between foreign public funds and RICs.[360] The SEC has also received comment supporting the preservation of the existing conditions of the exclusion.[361]

The SEC has received comment that the home jurisdiction requirement under the 2013 rule is narrow and fails to recognize the prevalence of non-U.S. retail funds organized in one jurisdiction and authorized to sell interests in other jurisdictions.[362] For example, the SEC received comment that a banking entity sponsor may choose the domicile of a foreign public fund based on tax treatment, investment strategy, or flexibility to distribute into multiple markets (for instance, in the European Union).[363] The SEC recognizes that the home jurisdiction requirement may be impeding activity in foreign public funds that are organized and sold across different jurisdictions. While such offerings may not be subject to the laws and regulations of the foreign public fund's home jurisdiction, they are subject to the local laws and regulations of the jurisdictions in which the foreign public fund is authorized to sell ownership interests. The elimination of the home jurisdiction requirement may benefit such foreign public funds and may facilitate greater capital formation through such funds, with the potential to create more capital allocation choices for investors. To the degree that the 2013 rule may currently be disadvantaging foreign public funds relative to otherwise comparable RICs, the elimination of the home jurisdiction requirement may dampen such competitive disparities.

The SEC has also received comment that the ''predominantly'' requirement has been burdensome and poses significant compliance burdens.[364] For example, banking entities may not fully observe and predict both historical and potential future distributions of funds that are sponsored by third parties, listed on exchanges, or sold through third-party intermediaries or distributors.[365] To the degree that some banking entities are currently unable to quantify the volumes of distributions through foreign public offerings relative to, for instance, foreign private placements, the proposed amendment may enable greater activity of banking entities relating to foreign public funds. Similar to the above discussion, this aspect of the proposed amendment also provides for a similar treatment of RICs (which are not required to monitor or assess distributions) and foreign public funds, with corresponding competitive effects.

The proposed amendments to the foreign public funds provisions tailor the scope of disclosure and compliance obligations for those jurisdictions where ownership interests are sold in recognition of the prevalence of foreign retail fund sales across jurisdictions. Similarly, the proposal would limit the compliance obligation to settings in which the banking entity serves as the investment manager, investment adviser, commodity trading advisor, commodity pool operator, or sponsor—settings that may involve greater conflicts of interest between banking entities and fund investors.

The proposed amendments also would replace the employee sales limitation with a limitation on sales to senior officers.[366] The SEC has received comment that banking entities may face significant costs and logistical and interpretive challenges monitoring investments by their employees, including those who transact in fund shares through unaffiliated brokers or through independent exchange trading.[367] The SEC has also received comment that the employee sales limitation serves no discernible anti-evasion purpose.[368] In addition, commenters noted that employee ownership interest can be a meaningful mechanism of promoting incentive alignment.[369] The proposed amendments would replace the employee sales limitation with a corresponding sales limitation with respect only to senior officers. This change may reduce these reported compliance challenges and burdens while preserving in part the original anti-evasion purpose of the limitations on employee ownership.

The agencies could have proposed a variety of alternatives offering more or less relief with respect to foreign public funds. For example, the agencies could have proposed eliminating altogether the limit on sales to affiliated entities, directors and employees, which would have provided even greater alignment of treatment between foreign public funds and RICs.[370] Alternatives providing greater relief with respect to foreign public funds may facilitate greater banking entity activity and intermediation of such funds on the one hand, but they may also strengthen the competitive positioning of foreign public funds relative to U.S. registered funds. Moreover, providing greater relief with respect to foreign public funds may allow banking entities greater flexibility in the formation and operation of foreign public funds, but may also increase the risk that banking entities are able to use foreign public funds to engage in activities that the restrictions on covered funds were intended to prohibit, thereby reducing the magnitude of the expected economic benefits of section 13 of the BHC Act and the 2013 rule. Similarly, relative to the proposed amendments, alternatives providing less relief with respect to foreign public funds may strengthen the competitive positioning of U.S. RICs relative to foreign public funds and pose lower compliance or evasion risks, but may also reduce the benefits of the relief for capital formation in foreign public funds and their investors.

Credit Funds

Under the baseline, funds that raise capital to engage in loan originations or extensions of credit or purchase and hold debt instruments that a banking entity would be permitted to acquire directly may be ''covered funds'' under the 2013 rule. As a result, banking entities currently face limitations on sponsoring or investing in credit funds that engage in traditional banking activities—activities that banking entities are able to engage in directly outside of the fund structure. Banking entities may also be restricted in their relationships with credit funds that are related covered funds, as well as in their underwriting and market making activities relating to such funds. The proposal would create a separate exclusion from the covered fund definition for credit funds that meet certain conditions, including several conditions that are similar to certain conditions of the loan securitization exclusion, but that reflect the structure and operation of credit funds.

Credit funds are likely to carry similar returns and risks as direct extensions of

[358] *See* proposed rule § __.10(c)(1)(iii)(B).

[359] *See* proposed rule § __.10(c)(1)(ii)(D).

[360] *See, e.g.,* ABA; BPI; FSF; SIFMA; ICI; IIB; JPMAM.

[361] *See, e.g.,* Data Boiler.

[362] *See, e.g.,* ABA; BPI.

[363] *See, e.g.,* FSF; SIFMA.

[364] *See, e.g.,* BPI.

[365] *See* id.

[366] *See* proposed rule § __.10(c)(1)(ii)(D).

[367] *See, e.g.,* SIFMA; JPMAM.

[368] *See* id.

[369] *See* BPI.

[370] *See, e.g.,* FSF.

credit and loan origination outside of the fund structure, including the possibility of losses or gains related to changes in interest rates, borrower default or delinquent payments, fluctuations in foreign currencies, and overall market conditions. While the presence of a fund structure may introduce risks, *e.g.,* those related to governance of the fund and those related to relying on third-party investors providing capital to the fund, the SEC preliminarily believes those risks to banking entities to be limited. Moreover, fund structures may entail risk mitigating features (such as diversification across a larger number of borrowers) as well as significant cost efficiencies for banking entities. The SEC has received comment supporting an exclusion for credit funds. For example, some commenters suggested that a fund or partnership structure enables banking entities to engage in permissible activities more efficiently.[371] Specifically, one commenter indicated that credit funds facilitate investments by third parties, leading to the creation of a broader and deeper pool of capital, which may allow for more diversification in lending portfolios, the pooling of expertise of groups of market participants, and otherwise reduce the risk for banking entities and the financial system.[372] In addition, to the degree that credit funds require precommitments of capital, they may dampen cyclical fluctuations in loan originations and may facilitate ongoing extensions of credit during times of market stress.[373]

Another commenter indicated that debt instruments are generally held for the purpose of generating income, which may come both from interest and price appreciation, whether held directly on a banking entity's balance sheet or indirectly through a fund structure.[374]

Further, commenters have stated that some RICs and BDCs may engage in similar investment activities as credit funds.[375] The risks and returns of the core activities of credit funds may be similar to those of RICs and publicly offered business development companies that have an investment strategy to buy and hold debt instruments. The SEC has also received comment that, while some credit funds may be able to avail themselves of the existing exclusions for loan securitizations and joint ventures, those exclusions are not sufficient to accommodate the full range of credit funds and activities.[376]

The SEC preliminarily believes that the proposed credit fund exclusion may allow banking entities to engage, indirectly, in more loan origination and traditional extension of credit relative to the current baseline. To the degree that banking entities are currently constrained in their ability to engage in extension of credit through credit funds because of the 2013 rule, the proposed exclusion may increase the volume of intermediation of credit by banking entities and make it more efficient and less costly. In addition, permitting banking entities to extend financing to businesses through credit funds could 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 and thereby likely result in an increase in lending activity in banking entity-sponsored credit funds without negatively affecting capital formation or the availability of financing. In this respect, the proposed amendments could result in greater competition between bank and non-bank provision of credit with both expected lower costs that typically result from increased competition and a larger volume of permissible banking and financial activities to occur in the regulated banking system. In addition, since cost reductions and increased efficiencies are commonly passed along to customers, the proposed exclusion may also benefit banking entities' borrowers and facilitate the extension of credit in the real economy.

The SEC continues to recognize that banking entities already engage in a variety of permissible activities involving risk, including extensions of credit, underwriting, and market-making. To the degree that credit funds may enable greater formation of capital by banking entities through various debt instruments, this may influence the risks and returns of banking entities individually and of banking entities as a whole. However, the SEC recognizes that the activities of credit funds largely replicate permissible and traditional activities of banking entities. Moreover, banking entities subject to the 2013 rule may also be subject to multiple prudential, capital, margin, and liquidity requirements that facilitate the safety and soundness of banking entities and promote the financial stability of the United States. In addition, the proposed amendments include a set of conditions on the credit fund exclusion, including limitations on banking entities' guarantees, assumption or other insurance of the obligations or performance of the fund,[377] and compliance with applicable safety and soundness standards.[378]

Importantly, extensions of credit and loan origination by banking entities, whether directly or indirectly, are influenced by a wide variety of factors, including the prevailing macroeconomic conditions, the creditworthiness of borrowers and potential borrowers, competition between bank and non-bank credit providers, and many others. Moreover, the efficiencies of credit funds relative to direct extensions of credit described above are likely to vary considerably among banking entities and funds. The SEC recognizes that the potential effects described above of the proposed credit fund exclusion may be dampened or magnified in different phases of the macroeconomic cycle and across various types of banking entities.

As an alternative to the proposed amendment, the agencies could have proposed a credit fund exclusion that imposes additional restrictions. For example, as discussed above, the agencies could have imposed a quantitative limit on the amount of equity securities (or rights to acquire equity securities) that a credit fund may acquire in connection with its loans or debt instruments, rather than to require only that such securities and rights be received on customary terms. The SEC understands that in certain circumstances it is customary for lenders to receive a limited amount of warrants issued by the borrower or its affiliate in connection with certain extensions of credit, and that such a structure (*e.g.,* a note with warrants attached) can facilitate the availability of financing for small businesses and early stage companies that may be provided through credit funds. The SEC believes that there may be practical challenges to imposing and calculating a quantitative limit (for example, upon issuance, warrants could be worth relative little but the value could grow substantially over time). To the degree that a quantitative limit may result in unintended consequences and may impede the ability of some credit funds to provide financing to certain borrowers, particularly small businesses and early stage companies, the proposed condition could provide greater relief with respect to credit funds and potential borrowers relative to the alternative. At the same time, the

[371] *See, e.g.,* ABA.

[372] *See* id.

[373] *See* id.

[374] *See* Credit Suisse.

[375] *See* id.

[376] *See, e.g.,* FSF; GS.

[377] *See* proposed rule § __.10(c)(15)(iv)(A).

[378] *See* proposed rule § __.10(c)(15)(v)(B).

alternative would impose greater restrictions on the credit fund exclusion, reducing the above benefits and potentially increasing costs for banking entities and borrowers.

Venture Capital Funds

As discussed elsewhere in this **SUPPLEMENTARY INFORMATION**, the agencies are proposing to exclude certain venture capital funds from the definition of ''covered fund,'' which would allow banking entities to acquire or retain an ownership interest in, or sponsor, those venture capital funds to the extent the banking entity is otherwise permitted to engage in such activities under applicable law.[379] The exclusion would be available with respect to qualifying venture capital funds, which would include an issuer that meets the definition of ''venture capital fund'' in 17 CFR 275.203(l)-1 and that meets several additional criteria.[380]

A qualifying venture capital fund would be an issuer that, among other criteria, is a venture capital fund as defined in 17 CFR 275.203(l)–1.[381] 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.[382] 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.[383] The SEC further explained that its regulation's 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.[384] The SEC preliminarily believes that this definition includes criteria reflecting the characteristics of venture capital funds that 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.

A number of commenters supported an exclusion for venture capital funds and stated that venture capital funds do not commonly engage in short-term, high-risk activities, and that, by their nature, venture capital funds make long-term investments in private firms.[385] Moreover, the SEC received comment that venture capital funds promote economic growth and competitiveness of the U.S. more effectively than investments in expressly permissible vehicles, such as small business investment companies.[386] The SEC has also received comment that, by virtue of their investment strategy, long-term investment horizon, and intermediation between companies in need of capital and institutional investors seeking to deploy capital in efficient ways, venture capital funds may play a significant role in capital formation, economic growth, and efficient market function.[387] The proposed venture capital fund exclusion may provide banking entities with greater flexibility in their investments in private firms and private firms with a broader range of financing sources.

In addition, it is widely noted that the availability of venture capital and other financing from funds is not uniform throughout the United States and 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).[388] 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, further promoting capital formation.

The SEC remains cognizant of the fact that the overall level and structure of activities of banking entities that involve risk stems from a variety of permissible sources, including traditional capital provision, underwriting, and market-making. To the degree that qualifying venture capital funds may enable greater formation of capital by banking entities, this may influence the risks and returns of such entities individually and of banking entities as a whole. However, the proposed exclusion has a number of conditions, including a prohibition on direct or indirect guarantees by the banking entity, disclosures to investors, and compliance with applicable safety and soundness standards.

The SEC has also received comment opposing any exclusion for venture capital funds.[389] The SEC recognizes that venture capital funds commonly invest in illiquid private firms with few sources of market price information, with corresponding risks and returns. To the degree that the proposed exclusion for venture capital funds could facilitate banking entity activities related to venture capital funds, this proposed exclusion could increase the volume and alter the structure of banking entities' activities, affecting the risks associated with those activities. At the same time, as discussed elsewhere,[390] many other traditional and permissible activities of banking entities involve risk, and the provision of capital to private firms is an important function of banking entities within the financial system and securities markets that benefits the real economy.

As an alternative to the proposed amendment, the agencies are considering an additional restriction for which they are seeking specific comment. Under this additional restriction, and notwithstanding 17 CFR 275.203(1)–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. The agencies are considering what specific threshold would be appropriate to differentiate venture capital funds from other types of private funds. The potential benefit of including a revenue or other similar test is that it could be more difficult for

[379] *See* proposed rule § __.10(c)(16).

[380] *See supra* section III.C.2.

[381] *See id* for a discussion of the SEC's definition of ''venture capital fund'' in 17 CFR 275.203(l)–1. Following enactment of the RBIC Advisers Relief Act, the SEC's definition of ''venture capital fund'' includes any RBIC and any SBIC. *See* 15 U.S.C. 80b–3(l). The agencies are requesting comment on whether they should provide a separate, specific exclusion from the definition of ''covered fund'' for RBICs. *See supra* note 328.

[382] *See, e.g.,* 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 39645, 39656 (July 6, 2011).

[383] *See id. at* 39648 (''[T]he proposed definition of venture capital fund was designed to . . . address concerns expressed by Congress regarding the potential for systemic risk.''); and at 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 of the nature of investments of a venture capital fund, and these principles guided our consideration of the proposed venture capital fund definition.'').

[384] *See id.*at 39662. *See also id.* at 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.'').

[385] *See, e.g.,* ABA; BPI; Federated; Hultgren.

[386] *See id.*

[387] *See, e.g.,* BPI.

[388] *See, supra* note 152.

[389] *See, e.g.,* Data Boiler.

[390] *See* 2019 amendments at 62037–92.

banking entities to use the exclusion for qualifying venture capital funds to make investments that the agencies may not have intended to be permitted by this exclusion. However, any such anti-evasion benefits of this alternative could be offset by the extent to which anti-evasion concerns are already addressed by the other conditions of the proposed exclusion for qualifying venture capital funds.

Such an additional restriction as contemplated in the alternative would make it more difficult for banking entities to sponsor and invest in venture capital funds by limiting the pool of possible investments permitted for venture capital funds that qualify for the exclusion. This difficulty may be particularly pronounced for banking entities that would use the proposed venture capital fund exclusion to make investments in third-party venture capital funds, which may not be willing to restrict—and could be prohibited from restricting under other applicable laws—the fund's investments in companies that meet any such additional revenue or other similar test. As a result, such an additional condition could diminish the benefits discussed above, both by limiting the utility of the exclusion for banking entities to make permissible long-term investments and potentially reducing the availability of financing for businesses, including small businesses and start-ups in areas outside of certain major metropolitan areas.

Small Business Investment Companies

The 2013 rule excludes from the covered fund definition small business investment companies (SBICs). The 2013 rule includes within the scope of the exclusion SBICs and issuers that have received notice to proceed to qualify for a license as an SBIC and which have not received a revocation of the notice or license. The proposal would expand the exclusion to incorporate SBICs that have voluntarily surrendered their licenses to operate and do not make new investments (other than investments in cash equivalents) after such voluntary surrender.[391]

Clarifying that SBICs that have voluntarily surrendered their licenses and are winding-down remain excluded from the covered fund definition would eliminate regulatory uncertainty for banking entities. Currently, because it is unclear whether an SBIC that has voluntarily surrendered its license is still excluded from the definition of ''covered fund,'' banking entities must make a determination whether or not the SBIC that is winding-down is a covered fund. If the banking entity determines that when the SBIC that is winding-down and has voluntarily surrendered its license no longer qualifies for the exclusion from the covered fund definition, then the 2013 rule applies and the banking entity's existing investment in, and relationship with, the SBIC is prohibited. This potential result may discourage banking entities from making investments in SBICs.

The SEC has received comment that the 2013 rule is limiting banking entity activities in SBICs that may spur economic growth, and that banking entities face significant regulatory burdens that are not commensurate with the risk of the underlying activities.[392] Another commenter indicated that, in the ordinary course of business, SBIC fund managers often relinquish or voluntarily surrender a license during the wind-down of the fund while liquidating assets in the dissolution process (since the license is no longer necessary or an efficient use of partnership funds).[393]

SBICs are an important mechanism for capital allocation by banking entities and one important channel of capital raising for issuers. The proposed amendment would clarify that banking entities are able to continue to participate in SBIC-related activities during the dissolution of such funds, as long as certain conditions are met. To the degree that banking entities may currently be reluctant to invest in SBICs to avoid the risk of an SBIC being treated as a covered fund during SBIC dissolution, the proposal may increase the willingness of some banking entities to participate in SBICs. The proposed amendment would require that SBICs that have voluntarily surrendered their license may not make new investments during the wind-down process. This aspect of the proposed amendment seeks to address the possibility of banking entities becoming exposed to greater risk as part of their participation in SBICs during their wind-down process, even though such exposure may not be common in an SBIC's ordinary course of business. In any case, both the risks and the returns arising out of banking entity investments in SBICs at all stages of the vehicle's lifecycle are likely to flow through to banking entity shareholders. Moreover, banking entities participating in SBICs would remain subject to applicable safety and soundness regulations and requirements.

Public Welfare Funds

Similarly, as discussed elsewhere in this **SUPPLEMENTARY INFORMATION**, the SEC has received comment that the 2013 rule's exclusion for public welfare funds may not capture community development investments made through investment vehicles and comment supporting an exclusion of investments that qualify for Community Reinvestment Act (CRA) credit, including direct and indirect investments in a community development fund, SBIC, or similar fund.[394] The agencies are requesting comment on, among others, a separate exclusion from the covered fund definition for CRA-qualified investments or the incorporation of such an exclusion in the exclusion for public welfare investments. To the degree that some banking entities face uncertainty about their ability to make CRA-qualified investments and qualify for the exclusion, an explicit exclusion for such funds may increase the willingness of banking entities to intermediate such community development investments. At the same time, to the degree that banking entities currently finance community development projects eligible for the CRA through other fund structures and rely on corresponding exemptions, the economic effects of a potential exclusion for CRA-qualified investments may be limited to the difference in compliance burdens between such a new exclusion and existing covered fund exclusions.

The agencies are requesting comment on providing a separate specific exclusion for RBICs, similar to the separate, specific exclusion for SBICs.[395] As the SEC discussed elsewhere,[396] RBICs are intended to promote economic development and the creation of wealth and job opportunities in rural areas and among individuals living in such areas,[397] and their purpose is similar to the purpose of SBICs and public welfare companies.[398] Because SBICs and RBICs share the common purpose of promoting capital formation in their respective sectors, advisers to SBICs and RBICs are treated similarly

[391] *See* proposed rule § __.10(c)(11)(i).

[392] *See, e.g.,* SBIA; Capital One.

[393] *See, e.g.,* BB&T.

[394] *See* ABA.

[395] *See supra* note 328.

[396] *See* Accredited Investor Definition Proposing Release, at 2586–7.

[397] *See* U.S. Department of Agriculture, Rural Business Investment Program Overview, *available at http://www.rd.usda.gov/programs-services/rural-business-investment-program.*

[398] SBICs are intended to increase access to capital for growth stage businesses. *See* U.S. Small Business Administration, SBIC Program Overview, *available at https://www.sba.gov/partners/sbics.*

under the Advisers Act (in that they have the opportunity to take advantage of exemptions from investment adviser registration).[399] This alternative would expand the economic effects of the proposed SBIC exclusion discussed above and may facilitate capital formation by banking entities in growth stage businesses.

RBICs may already be excluded from the definition of covered fund under the 2013 rule.[400] For example, RBICs may qualify for the public welfare exclusion under the 2013 rule or an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act other than section 3(c)(1) or 3(c)(7). To the extent that RBICs may already be excluded from the definition of covered fund, an express exclusion for RBICs would provide clarity and certainty and reduce costs for banking entities, which may otherwise be required to conduct a case-by-case analysis of each RBIC to determine whether it qualifies for an exclusion or exemption under the 2013 rule.

The agencies are also requesting comment on providing a specific exclusion for QOFs. As discussed above, the program allows taxpayers to defer and reduce taxes on capital gains by reinvesting gains in QOFs that are required to have at least 90 percent of their assets in designated low-income zones. In this regard, QOFs are similar to SBICs and public welfare companies. The alternative could expand the economic effects of the proposed amendments to the SBIC exclusion and public welfare exclusion discussed above, and may facilitate capital formation by banking entities.

QOFs may already be excluded from the definition of covered fund under the 2013 rule. For example, QOFs may qualify for the public welfare exclusion under the 2013 rule or an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act other than section 3(c)(1) or 3(c)(7), such as section 3(c)(5)(C).[401] In addition, depending on the facts and circumstances, an issuer that holds securities issued by a QOF may not meet the definition of ''investment company'' under Section 3(a)(1) of the Investment Company Act, may be excluded under Rule 3a–1 thereunder, or may qualify for the exclusion under Section 3(c)(6) of the Investment Company Act.[402] To the extent that QOFs may already be excluded from the definition of covered fund, an express exclusion for QOFs would provide clarity and certainty and reduce costs for banking entities, which may otherwise be required to conduct a case-by-case analysis of each QOF to determine whether it qualifies for an exclusion or exemption under the 2013 rule.

Family Wealth Management Vehicles

As discussed above, the proposed amendments would exclude from the covered fund definition certain family wealth management vehicles. Family wealth management vehicles commonly engage in asset management activities, as well as estate planning and other related activities.[403] The SEC understands that some banking entities may currently be constrained in providing traditional banking and asset management services, including, for example, investment advice, brokerage execution, financing, clearing, and settlement services, to family wealth management vehicles due to the 2013 rule.[404] In addition, the SEC understands that certain family wealth management vehicles that are structured as trusts may prefer to appoint banking entities as trustees acting in a fiduciary capacity.[405] By specifically excluding family wealth management vehicles, the proposal may benefit such banking entities by permitting them to offer services to and engage in transactions with family wealth management vehicle customers. Importantly, the proposed amendment may benefit family wealth management vehicles and their investment advisers by increasing the spectrum of banking entity counterparties willing to provide traditional client-oriented financial and asset management services. Thus, the proposed amendment may enhance competition among banking and non-banking entities providing financial services to family wealth management vehicles and may lead to more efficient capital allocation of family wealth management vehicles' funds. To the degree banking entities pass compliance costs on to customers, family wealth vehicles may experience costs savings from the proposed amendment as well.

The SEC recognizes that some banking entities may respond to the proposed exclusion by seeking to structure other entities as family wealth management vehicles. However, as discussed in detail above, the proposed exclusion would only be available under a number of conditions. Specifically, if the entity is a trust, the grantor(s) of the entity must all be family customers; if the entity is not a trust, a majority of the voting interests in the entity must be owned by family customers, and the entity must be owned only by family customers and up to 3 closely related persons of the family customers.[406] In addition, banking entities may rely on this exclusion only if they: provide bona fide trust, fiduciary, investment advisory, or commodity trading advisory services to the entity;[407] do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such entity;[408] comply with the disclosure obligations under § __.11(a)(8), as if such entity were a covered fund;[409] do 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;[410] comply with the requirements of §§ __ .14(b) and __.15, as if such entity were a covered fund;[411] and 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.[412]

The proposed definition of ''family customer'' would include any ''family client'' as defined in Rule 202(a)(11)(G)-1(d)(4) of the Investment Advisers Act of 1940, and 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.[413] The SEC believes that the conditions for the proposed exclusion and the proposed definition of ''family customer'' would require family wealth management vehicles to be used on arms-length, market terms for customer-oriented financial services, and the SEC preliminarily believes that this will reduce the risk that banking entities' involvement in these vehicles will give rise to the types of risks that

[399] *See supra* note 331. The private fund adviser exemption excludes the assets of RBICs and SBICs from counting towards the $150 million threshold. 15 U.S.C. 80b–3(m).

[400] RBICs may be excluded under the proposed venture capital exclusion. *See supra* note 331.

[401] *See* Opportunity Zone Statement.

[402] *See* id.

[403] *See e.g.,* IAI; SIFMA.

[404] *See e.g.,* BPI; IAI; SIFMA.

[405] *See* SIFMA.

[406] *See* proposed rule § __.10(c)(17)(i).

[407] *See* proposed rule § __.10(c)(17)(ii)(A).

[408] *See* proposed rule § __.10(c)(17)(ii)(B).

[409] *See* proposed rule § __.10(c)(17)(ii)(C).

[410] *See* proposed rule § __.10(c)(17)(ii)(D).

[411] *See* proposed rule § __.10(c)(17)(ii)(E).

[412] *See* proposed rule § __.10(c)(17)(ii)(F).

[413] *See* proposed rule § __.10(c)(17)(iii).

the covered funds provisions are meant to mitigate.

Alternative forms of relief with respect to family wealth management vehicles—for example, alternatives that define ''family customers'' more broadly or narrowly, or alternatives removing some of the proposed conditions for the exclusion—would increase or reduce the availability of the exclusion relative to the proposal. Alternatively, the agencies could have proposed amending the limitations on relationships with a covered fund to permit banking entity transactions with family wealth management vehicles that would otherwise be considered covered transactions (*e.g.,* ordinary extensions of credit) without subjecting them to 12 CFR 223.15(a) or section 23B of the Federal Reserve Act, as if such banking entity were a member bank and such family wealth management fund were an affiliate thereof. Broader (narrower) alternative forms of relief may increase (decrease) the magnitude of the economic benefits for capital formation, allocative efficiency, and the ability of banking entities to provide traditional customer oriented services to family wealth management vehicles. At the same time, such broader relief may increase the risk that some banking entities may respond to the relief by attempting to evade the intent of the rule, increasing the volume of their activities with family wealth management vehicles. Nevertheless, such risks of the alternatives relative to the proposed exclusion may be mitigated by the fact that banking entities would remain subject to the full scope of broker-dealer and prudential capital, margin, and other rules aimed at facilitating safety and soundness. Moreover, as discussed above, the SEC preliminarily believes that traditional banking and asset management services involving family wealth management vehicles do not involve the types of risks that section 13 of the BHC Act was designed to address.

Customer Facilitation Vehicles

The proposal would also exclude from the covered fund definition issuers acting as customer facilitation vehicles. The SEC understands that banking entities commonly use special purpose vehicles to accommodate exposure to securities, transactions, and services of a client or group of affiliated clients.[414] The SEC has received comment that, because of the 2013 rule's covered fund restrictions, some banking entities have been unable to engage in traditional banking and asset management services with respect to vehicles provided for customers, even though banking entities are otherwise able to provide such exposures and services to customers directly (outside of the fund structure).[415] The SEC has also received comment that some clients, particularly clients in markets such as Brazil, Germany, Hong Kong, and Japan, prefer to transact with or through such vehicles rather than banking entities directly because of a variety of legal, counterparty risk management, and accounting factors.[416] Moreover, the SEC is aware that limitations of the 2013 rule on the activities of such vehicles may be disrupting client relationships, reducing the efficiency of customer-facing financial services, and raising compliance costs of banking entities.[417] The proposed exclusion may eliminate these baseline costs and inefficiencies by allowing banking entities to provide customer-oriented financial services through vehicles, the purpose of which is providing such customers with exposure to a transaction, investment strategy, or other service. As a result, banking entities may become better able to engage in the full range of customer facilitation activities through special purpose vehicles and fund structures, which may benefit banking entities, their customers, and securities markets more broadly.

At the same time, financial services related to customer facilitation vehicles may involve market risk, and the proposed exclusion may enable banking entities to provide a greater array of financial services to, and otherwise transact with, such vehicles. The SEC preliminarily believes that such risks may be mitigated by at least two of the proposed conditions of the proposed exclusion. First, a banking entity and its affiliates can hold only a *de minimis* (up to 0.5%) interest in the customer facilitation vehicle for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.[418] Second, a banking entity and its affiliates may not directly or indirectly guarantee, assume, or otherwise insure the obligations or performance of the vehicle.[419] These proposed conditions, among the other conditions in the proposal, may mitigate risks that may be borne by individual banking entities and by banking entities as a whole as a result of the proposed exclusion, and may facilitate banking entities' ongoing compliance with section 13 of the BHC Act and the implementing regulations. Moreover, the SEC continues to believe that the provision of customer-oriented financial services by banking entities may benefit customers, counterparties, and securities markets.

The proposed amendments create new recordkeeping requirements for a banking entity that relies on the exclusion for customer facilitation vehicles.[420] The banking entity may only rely on the exclusion if it and its affiliates maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to a transaction, investment strategy or service offered by the banking entity. As discussed in section IV.B [421] and above, these recordkeeping burdens may impose a total initial burden of $1,078,650 [422] and a total ongoing annual burden of $1,078,650.[423]

The agencies could have proposed alternative forms of relief with respect to customer facilitation vehicles. For example, the agencies could have proposed a higher banking entity ownership limit (of, for example, 5% or 10%). Alternatively, the agencies could have proposed a 0.5% ownership interest limit, but without specifying a list of purposes for which such interest may be held, leading to banking entities accumulating greater ownership interests in such vehicles. As another example, the agencies could have proposed an exclusion for customer facilitation vehicles without subjecting the banking entity relying on the exclusion to 12 CFR 223.15(a) or section 23B of the Federal Reserve Act, as if such banking entity were a member bank and such customer facilitation vehicles were an affiliate thereof. Such alternatives would remove or loosen the conditions for the availability of the exclusion, which may increase the risk that customer facilitation vehicles could be used for evasion purposes or expose banking entities to additional risk, but could also further reduce compliance burdens and provide greater flexibility to banking entities and their customers.

b. Restrictions on Relationships Between Banking Entities and Covered Funds

As discussed above, under the 2013 rule, banking entities that either: (1) Serve as a sponsor, adviser, or manager of a covered fund; (2) organize and offer

[414] *See, e.g.,* ABA.

[415] *See, e.g.,* SIFMA; FSF; ABA.

[416] *See, e.g.,* ABA; BPI.

[417] *See, e.g.,* ABA; FSF.

[418] *See* proposed rule § __.10(c)(18)(ii)(B)(4).

[419] *See* proposed rule § __.10(c)(18)(ii)(B)(2).

[420] *See* proposed rule § __.10(c)(18)(ii)(B)(1).

[421] *See supra* note 338.

[422] *See supra* note 339.

[423] *See supra* note 340.

a covered fund under __.11; or (3) hold an ownership interest under __.11(b) are unable to engage in any covered transactions with such funds.[424] This prohibition may be limiting the services that such banking entities and their affiliates are able to provide to certain entities that are covered funds under the 2013 rule. For example, as noted above, banking entities are significantly limited in their ability to both organize and offer a covered fund, as well as to provide custody services to the fund. The proposed amendments would authorize banking entities to engage in certain transactions, such as extensions of intraday credit, payment, clearing, and settlement services, with covered funds—activities that could otherwise be covered transactions.[425]

The SEC has received comments suggesting that section 13(f)(1) of the BHC Act should be interpreted to include the exemptions provided under section 23A of the Federal Reserve Act, and that banking entities should be permitted to engage in a limited amount of covered transactions with related covered funds.[426] The SEC recognizes that outsourcing such activities to third parties may be adversely affecting customer relationships, increasing costs, and decreasing operational efficiency for banking entities and covered funds. The proposed amendments would provide banking entities greater flexibility to provide these and other services directly to covered funds. If being able to provide custody, clearing, and other services to related covered funds reduces the costs of these services and risks of operational failure of fund custodians, then fund advisers and, indirectly, fund investors, may benefit from the proposed amendments. Many direct benefits are likely to accrue to banking entity advisers to covered funds that are currently relying on third-party service providers as a result of the requirements of the 2013 rule.

The proposed amendments may increase banking entities' ability to engage in custody, clearing, and other transactions with related covered funds and benefit banking entities that are currently unable to engage in otherwise profitable or efficient activities with related covered funds. Moreover, this may enhance operational efficiency and reduce operational risks and costs incurred by covered funds, which are currently unable to rely on banking entities with which they have certain relationships for custody, clearing, and other transactions.

The SEC has also received a comment opposing incorporating the Federal Reserve Act section 23A exemptions or quantitative limits.[427] To the extent that the proposed approach may increase transactions between banking entities and related covered funds, banking entities could incur risks associated with these transactions. However, as discussed above, the proposed amendments impose a number of conditions aimed at reducing overall risks to banking entities, the ability of banking entities to lever up related covered funds, and the incentive of banking entities to bail out related covered funds, while enhancing their ability to provide ordinary-course banking, custody, and asset management services, and facilitate capital formation in covered funds.

The agencies could have proposed broader or narrower forms of relief. For example, in addition to the proposed relief, the agencies could have proposed permitting banking entities to engage in additional covered transactions in connection with payment, clearing, and settlement services beyond extensions of credit and purchases of assets. Further, under the proposal, each extension of credit would be required to be repaid, sold, or terminated by the end of 5 business days.[428] As another alternative, the agencies could have proposed allowing extensions of credit in connection with payment transactions, clearing, or settlement services for periods that are longer than 5 business days. However, the proposed 5 business day criteria is 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.[429] In addition, the agencies could have imposed quantitative limits on the newly permitted covered transactions tied to bank capital or fund size. Relative to the proposed amendments, alternatives providing greater relief with respect to covered transactions with covered funds could magnify the cost savings and operational risk benefits described above, but may also increase risk to banking entities or the incentives for banking entities to bail out related covered funds. Similarly, narrower alternative forms of relief may dampen the economic effects of the proposed amendments discussed above.

c. Definition of Ownership Interest

As discussed above, the 2013 rule defines ''ownership interest'' in a covered fund to mean any equity, partnership, or ''other similar interest,'' which is an interest that exhibits any of several characteristics.[430] This definition focuses on the attributes of the interest and whether it provides a banking entity with voting rights or economic exposure to the profits and losses of the covered fund. The agencies are proposing to amend the definition of ownership interest in two ways. First, the proposed amendment would specify that certain creditors' rights are excluded from the prong of the definition that defines an ownership interest to mean an interest that has the right to participate in the selection or removal of a general partner, investment adviser, or other service provider to the covered fund. Specifically, the proposed amendment would provide that an excluded creditors' right upon the occurrence of an event of default or an acceleration event can 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.[431] Accordingly, having this right would be recognized as a creditors' right that is excluded from the definition of ownership interest.

Second, the proposed amendment would add to the list of interests that are excluded from the definition of ownership interest. Specifically, the proposed amendment would provide that any senior loan or senior debt interest would not be an ownership interest, if such senior loan or senior debt interest had specific characteristics.[432] Those characteristics would be: (1) Under the terms of the interest, the holders 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 certain interest and fees, and fixed principal payments on or before a maturity date; (2) the right to payments are absolute and cannot be reduced because of the losses arising from the covered fund's underlying assets; and (3) the holders of the interest do not have the right to receive the underlying assets of the covered fund after all other interests have been redeemed or paid in full

[424] *See* 12 U.S.C. 1851(f)(1).

[425] *See* proposed rule § __.14(a)(2)(iii) and proposed rule § __.14(a)(2)(iv).

[426] *See, e.g.,* BPI; FSF.

[427] *See* Public Citizen.

[428] *See* proposed rule § __.14(a)(2)(iv)(B).

[429] *See supra* note 205.

[430] *See* 2013 rule § __.10(d)(6). *See also, supra,* section III.E.

[431] Proposed rule § __.10(d)(6)(i)(A).

[432] Proposed rule § __.10(d)(6)(ii)(B).

(excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event).[433]

The SEC has received comment that the 2013 rule's definition of ownership interest captures instruments that do not have equity-like features and constrains banking entity investments in debt securitizations and client facilitation services.[434] For example, one commenter indicated that analyzing the ownership interest definition in the context of securitizations has resulted in added time and costs of executing transactions, as well as impeded securitization transactions.[435] Moreover, the commenter indicated that the ''other similar interest'' prong of the definition precludes some banking entities from investing in collateralized loan obligation (CLO) senior debt instruments, which affects lending to CLOs, and that banking entities with pre-existing CLO exposures had to waive credit-enhancing remedies to avoid triggering the ownership interest restrictions.[436] In addition, the SEC received comment that the ownership interest definition in the 2013 rule may require an extensive legal analysis and documentation review and that, as a result, some banking entities may default to treating interests without controlling positions or equity-like features as ownership interests.[437]

The SEC recognizes that banking entities may have 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 their borrower that are not limited to the exercise of a remedy upon an event of default or other default event.[438] The proposed amendments may provide greater clarity and predictability to banking entities and enable them to determine whether they have an ownership interest under section 13 of the BHC Act and the implementing regulations. Moreover, to the degree that banking entities may have responded to the ownership interest definition in the 2013 rule by reducing their investments in certain debt instruments, the proposed amendments may result in greater banking entity investments in covered funds and greater ability of covered funds to allocate capital to the underlying assets.

The SEC recognizes that such debt instrument investments carry risk,[439] and that the risks and returns of such investments flow through to banking entities' shareholders. While the proposed amendments to the ownership interest definition may permit banking entities to increase exposures related to certain debt instrument transactions, three key considerations may mitigate the risks associated with such activities. First, the proposed amendments would not change any of the applicable prudential capital, margin, or liquidity requirements intended to ensure safety and soundness of banking entities. Second, to the degree that the ownership interest definition has actually discouraged banking entities from obtaining credit enhancements to avoid triggering the ownership interest restrictions, the proposed amendments may result in banking entities receiving stronger credit enhancements. Finally, the proposed amendments would include a number of conditions and restrictions aimed at reducing the risk to banking entities while facilitating traditional lending activity.

The agencies could have proposed broader relief by limiting the particular forms of a banking entity's interest (*e.g.,* equity or partnership shares) that would qualify as an ownership interest or by limiting the definition of ownership interest to ''voting securities'' as defined by the Board's Regulation Y. By providing broader relief relative to the proposed amendments, such an alternative may produce greater reductions in uncertainty and compliance burdens, and a greater willingness of banking entities to become involved in certain debt transactions. However, such greater involvement in certain debt transactions may also give rise to greater risks being borne by banking entities. The proposed amendments are intended to provide sufficient safeguards to prevent banking entities from acquiring interests in covered funds that run counter to the intentions of the 2013 rule and limit a banking entity's exposure to the economic risks of covered funds and their underlying assets, while reducing compliance uncertainty and increasing the willingness of banking entities to participate in covered funds.

d. Loan Securitizations

As discussed above, the 2013 rule excludes from the definition of covered fund any loan securitization that issues asset-backed securities, holds only loans, certain rights and assets, and a small set of other financial instruments (permissible assets), and meets other criteria.[440] The SEC has received comment that, as a result of the 2013 rule, some banking entities may have divested or restructured their interests in loan securitizations due to the narrowly-drawn conditions of the exclusion, and that a limited holding of non-loan assets may enable banking entities to provide traditional securitization products and services demanded by customers, clients, and counterparties.[441] Moreover, commenters indicated that the ability to hold non-loan assets may allow loan securitizations to increase diversification and enable asset managers to be more responsive to changing market demand for the underlying debt products.[442] Another commenter acknowledged the strong statutory and public policy arguments in favor of excluding credit securitizations.[443] Yet another commenter suggested that expanding permitted bank activities adds to the complexity of the 2013 rule, and that securitizations and asset-backed vehicles were involved directly in the 2008 financial crisis.[444]

The staffs of the agencies released a frequently asked question addressing the servicing asset provision of the loan securitization exclusion in June 2014.[445] The agencies are proposing to codify the staff-level approach to the loan securitization exclusion in the Loan Securitization Servicing FAQ.[446] To the degree that market participants may have restructured their activities consistent with the Loan Securitization Servicing FAQ, an effect of the proposed amendments may be to reduce uncertainty. However, the economic effects of the proposed amendments on enabling greater capital formation through loan securitizations on the one hand, and potential risks related to such activities on the other, may be limited.

The agencies are also proposing to allow loan securitizations to hold up to five percent of the entity's assets in non-

[433] *See supra* note 431.

[434] *See, e.g.,* BPI; SIFMA; ABA; Center for American Entrepreneurship; LSTA.

[435] *See, e.g.,* SFIG.

[436] *See* id.

[437] *See, e.g.,* SIFMA.

[438] See, *e.g.,* SFIG.

[439] *See, e.g.,* Occupy the SEC.

[440] *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. *See also* 2013 rule § __.2(t).

[441] *See, e.g.,* ABA; BPI.

[442] *See, e.g.,* IAA; LTSA.

[443] *See* Federated.

[444] *See* AFR.

[445] U.S. Securities and Exchange Commission, Responses to Frequently Asked Questions Regarding the Commission's Rule under Section 13 of the Bank Holding Company Act (the ''Volcker Rule'') (June 10, 2014), *available at https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm* (''Loan Securitization Servicing FAQ''). *See also, supra,* section III.B.2.

[446] Proposed rule § __.10(c)(8)(i)(B).

loan assets.[447] Several commenters on the 2018 proposal supported expanding the range of permissible assets that could be held by an excluded loan securitization.[448] Many commenters recommended allowing loan securitizations to hold up to five or ten percent of non-loan assets.[449] 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.[450] Authorizing loan securitizations to hold small amounts of non-loan assets could, consistent with the statute, 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 limits on the amount of non-loan assets also would reduce the potential risk that allowing certain non-loan assets could lead to evasion, indirect proprietary trading, and other impermissible activities. Moreover, loan securitizations provide an important avenue for banking entities to fund lending programs, and allowing loan securitizations to hold a small amount of non-loan assets in response to customer and market demand may increase a banking entity's capacity to provide financing and lending.

The agencies could have proposed expanding the types of permissible assets beyond what is described in the 2013 rule and the Loan Securitization Servicing FAQ. For example, the agencies could have proposed expanding the range of permissible assets in an excluded loan securitization. Such alternatives could potentially allow banking entities 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.

However, the SEC recognizes that the loan securitization industry may have evolved since the issuance of the 2013 rule. As a result, the SEC preliminarily believes that, even if the scope of non-loan assets permitted to be held were expanded, loan securitization issuers may continue to exclude non-loan assets from securitizations. Further, such an alternative would not affect the applicable prudential requirements aimed at safety and soundness of banking entities. Banking entities currently take on a variety of risks arising out of a broad range of permissible activities, including the core traditional banking activity related to the extension of credit and direct and indirect extension of credit by banking entities flows through to the real economy in the form of greater access to capital.

e. Parallel Investments

As discussed above, the preamble to the 2013 rule stated that if a banking entity makes investments side by side in substantially the same positions as a covered fund, then the value of such investments would be included for the purposes of determining the value of the banking entity's investment in the covered fund.[451] The agencies also stated that a banking entity that sponsors a covered fund should not make any additional side-by-side co-investment with the covered fund in a privately negotiated investment unless the value of such co-investment is less than three percent of the value of the total amount co-invested by other investors in such investment.[452]

In response to the 2018 proposal, the agencies received comments that argued the implementing regulations should not impose a limit on parallel investments and noted that such a restriction is not reflected in the text of the 2013 rule.[453] The agencies are proposing a rule of construction that (1) a banking entity will 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, and (2) a banking entity shall not be restricted 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.[454]

The SEC recognizes that the proposed approach may increase the risk that some banking entities may seek to use parallel investments for the purpose of artificially maintaining or increasing the value of the assets of a fund that is organized and offered by the banking entity. Supporting a fund in such a manner would increase these banking entities' exposures to the fund's assets and would generally be inconsistent with the 2013 rule's restriction on a banking entity guaranteeing, assuming, or otherwise insuring the obligations or performance of such a covered fund.[455]

Further, as stated above, the agencies would expect that any investments made alongside a covered fund by a director or employee of a banking entity or its affiliate, if made in compliance with applicable laws and regulations, would not be treated as an investment by the director or employee in the covered fund.

The SEC recognizes, however, that a restriction on investments made alongside a covered fund may interfere with banking entities' ability to make otherwise permissible investments directly on their balance sheets.[456] In particular, as noted by commenters, including the value of parallel investments within the ownership limits imposed on a banking entity or otherwise restricting a co-investment could prevent the banking entity from making investments that would otherwise be permissible under applicable laws and regulations.[457] In addition to removing impediments for banking entities' otherwise permissible investments, the proposed rule of construction may enable banking entities to make investments alongside a covered fund that will signal the quality of the investment(s) to the banking entities' clients and investors in the fund, and may also help align the incentives of banking entities, and their directors and employees, with those of the covered funds and their investors.

4. Efficiency, Competition, and Capital Formation

As discussed above, the proposed amendments would exclude certain groups of private funds and other entities from the scope of the covered fund definition and modify other covered fund restrictions applicable to banking entities subject to the implementing regulations. Moreover, the proposed amendments would reduce compliance obligations of banking entities subject to the implementing regulations. The SEC preliminarily believes that the proposed amendments may impact competition, capital formation, and allocative efficiency.

[447] Proposed rule § __.10(c)(8)(i)(E).

[448] *See e.g.,* IAA; LSTA; ABA; SFIG; GS; BPI; JBA; SIFMA.

[449] *See e.g.,* LSTA; JBA.

[450] *See* id.

[451] *See supra* section III.F and references therein.

[452] *See* id.

[453] *See* FSF; Goldman; SIFMA.

[454] Proposed rule § __.12(b)(5)(i).

[455] *See* 2013 rule § __.11(a)(5).

[456] *See supra* note 454.

[457] *See* id.

The proposed amendments may have three groups of competitive effects. First, the proposed amendments may make it easier for bank affiliated broker-dealers, SBSDs, and RIAs to compete with bank unaffiliated broker-dealers, SBSDs, and RIAs in their activities with certain groups of private funds and other entities. Second, the proposal may reduce competitive disparities between banking entities subject to the implementing regulations and affected by the proposed amendments, and banking entities that are not. Third, certain aspects of the proposed amendments (such as the amendments related to foreign excluded funds and foreign public funds) may reduce competitive disparities between U.S. banking entities and foreign banking entities in their covered fund activities. Because competition may reduce costs or increase quality, and because some affected banking entities may face economies of scale or scope in the provision of services to certain private funds, these competitive effects may flow through to customers, clients, and investors in the form of reduced transaction costs and greater quality of private fund and other offerings and related financial services.

The proposed amendments may also impact capital formation. For example, by reducing the scope of application of covered fund restrictions in the implementing regulations, the proposal relaxes restrictions related to banking entity underwriting and market-making of certain private funds. Moreover, the proposal would amend certain restrictions related to banking entity relationships with certain covered funds. Further, as discussed above, many of the proposed amendments would enable banking entities to engage indirectly (through a fund structure) in certain of the same activities that they are currently able to engage in directly (extending credit or direct ownership stakes). To the degree that the implementing regulations impede or otherwise constrain banking entity activities in such funds, the proposed amendments may result in a greater number of such private funds being launched by banking entities, increasing capital formation via private funds. The effects of the proposed amendments on capital formation are likely to flow through to investors (in the form of greater availability or variety or private funds available for investors) as well as to firms seeking to raise capital or obtain financing from private funds.[458]

The possible effects of the proposed amendments on allocative efficiency are related to the proposal's likely impacts on capital formation. Specifically, as discussed above, the SEC preliminarily believes that the proposed amendments may result in a greater number and variety of private funds launched by banking entities. To the degree that banking entities may be able to provide superior private funds due to their expertise or economies of scale or scope, and to the degree that fund structures may be more efficient than direct investments (due to, *e.g.,* superior risk sharing and pooling of expertise across fund investors), the proposed amendments may enhance the ability of market participants, investors, and issuers to allocate their capital efficiently.

The SEC recognizes that the proposed amendments may increase the ability of banking entities to engage in certain types of activities involving risk, and that increases in risk exposures of large groups of banking entities may negatively impact capital formation, securities markets, and the real economy, particularly during adverse economic conditions. Moreover, losses on investment portfolios may discourage capital market participation by various groups of investors. Three important considerations may mitigate these potential risks. First, as discussed throughout this economic analysis, banking entities already engage in a variety of permissible activities involving risk, including extensions of credit, underwriting, and market-making, and the activities of many types of private funds that would be excluded under the proposal largely replicate permissible and traditional activities of banking entities. Second, banking entities subject to the implementing regulations may also be subject to multiple prudential capital, margin, and liquidity requirements that facilitate the safety and soundness of banking entities and promote financial stability. Third, the proposed exclusions from the definition of covered fund each would include a number of conditions aimed at preventing evasion of section 13 of the BHC Act and the implementing regulations, promoting safety and soundness, and/or allowing for customer oriented financial services provided on arms-length, market terms.

Under the implementing regulations, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund if the banking entity organizes or offers the covered fund and satisfies other requirements. One such requirement is that the banking entity provide specified disclosures to prospective and actual investors in the covered fund.[459] Under the proposed amendments, the disclosures specified by § __.11(a)(8) would be required to satisfy the exclusions for credit funds and venture capital funds if the banking entity is a sponsor, investment adviser, or commodity trading advisor of the fund, and for family wealth vehicles and customer facilitation vehicles under all circumstances. To the extent that the proposed amendments lead banking entities to establish or provide services to more of these vehicles, the volume of information available to market participants could increase. Specifically, if banking entities respond to the proposed amendments by establishing or providing services to more of these vehicles because they are excluded from the definition of ''covered fund,'' then the amount of such disclosures would increase accordingly. However, the SEC preliminarily believes that the change in volume and type of information available to market participants is unlikely to have a significant impact on informational efficiency.

Importantly, the magnitude of the above effects on competition, capital formation, and allocative efficiency would be influenced by a large number of factors, such as prevailing macroeconomic conditions, the financial condition of firms seeking to raise capital, and of funds seeking to transact with banking entities, market saturation, and search for higher yields by investors during low interest rate environments. Moreover, the relative efficiency between fund structures and the direct provision of capital is likely to vary widely among banking entities and funds. The SEC recognizes that such economic effects may be dampened or magnified in different phases of the macroeconomic cycle and across various types of banking entities.

The SEC is unable to observe the amount of capital formation in different types of covered funds or underlying equity and debt securities that did not occur because of the 2013 rule. Because of the prolonged and overlapping implementation timeline of various post-crisis reforms, and because market participants restructured their trading and covered funds activities in anticipation of the 2013 rule being effective, the SEC cannot measure the counterfactual levels of capital formation and liquidity that would have

[458] For example, the proposed amendments could result in additional venture capital being available in geographic areas where it is relatively less available. *See supra,* section IV.F.3.a (Venture Capital Funds).

[459] 2013 rule § __.11(a)(8).

been observed after the financial crisis, absent the covered fund restrictions currently in place. Similarly, the SEC cannot quantify the degree to which competition in covered funds is adversely affected by the covered fund definition currently in effect. The SEC solicits any information, particularly quantitative data that would allow us to estimate the magnitudes of the potential costs and benefits of the proposed amendments on banking entity-affiliated broker-dealers and on banking entity-affiliated investment advisers advising the different types of funds discussed above. The SEC also solicits any information that would allow it to estimate any effects on efficiency, competition, and capital formation in different types of funds and their underlying securities.

5. Request for Comment

The SEC is requesting comment regarding all aspects of the economic analysis set forth here. To the extent possible, the SEC requests that market participants and other commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed amendments or any reasonable alternatives. In addition, the SEC asks commenters to consider the following questions:

Question SEC–1. What additional qualitative or quantitative information should the SEC consider as part of the baseline for its economic analysis of the proposed amendments?

Question SEC–2. What additional considerations can the SEC use to estimate the costs and benefits of implementing the proposed amendments for SEC-regulated banking entities?

Question SEC–3. Is it likely that certain potential benefits or costs associated with the proposed amendments will not be recognized by SEC-regulated banking entities because of the nature of their activities or because of new conditions or restrictions the proposal would impose on these activities? Why or why not? Are there other benefits or costs associated with the proposed amendments that will impact SEC-regulated banking entities differently than other types of banking entities?

Question SEC–4. Has the SEC considered all relevant aspects of the proposed amendments? Have we accurately described the costs and benefits of the proposed amendments? Why or why not? Please identify any other benefits associated with the proposed amendments in detail. Please identify any costs associated with the proposed amendments that we have not identified. If possible, please provide quantification or data that would enable a quantification of such effects.

Question SEC–5. What are the economic effects of the discussed reasonable alternatives? Are there any additional reasonable alternatives that the SEC should consider? If so, please identify such alternatives and any economic effects associated with such alternatives. If possible, please provide quantification or data that would enable a quantification of such effects.

Question SEC–6. Would permitting banking entities to invest in or sponsor a qualifying venture capital fund be likely to result in additional venture capital becoming available to start-ups and young, growing firms in geographic regions of the United States where such capital is relatively less available?

G. SEC Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [460] 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. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

List of Subjects

12 CFR Part 44

Banks, Banking, Compensation, Credit, Derivatives, Government securities, Insurance, Investments, National banks, Penalties, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Trusts and trustees.

12 CFR Part 248

Administrative practice and procedure, Banks, banking, Conflict of interests, Credit, Foreign banking, Government securities, Holding companies, Insurance, Insurance companies, Investments, Penalties, Reporting and recordkeeping requirements, Securities, State nonmember banks, State savings associations, Trusts and trustees.

12 CFR Part 351

Banks, banking, Capital, Compensation, Conflicts of interest, Credit, Derivatives, Government securities, Insurance, Insurance companies, Investments, Penalties, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Trusts and trustees.

17 CFR Part 75

Banks, Banking, Compensation, Credit, Derivatives, Federal branches and agencies, Federal savings associations, Government securities, Hedge funds, Insurance, Investments, National banks, Penalties, Proprietary trading, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Swap dealers, Trusts and trustees, Volcker rule.

17 CFR Part 255

Banks, Brokers, Dealers, Investment advisers, Recordkeeping, Reporting, Securities.

[460] Public Law 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).

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. Amend § 44.6 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. Amend § 44.10 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 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 advisor, 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);

(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) of this section, 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);

(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:

(*1*) 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) of this section 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)(l)(i) of subpart A of this part, 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), 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) *Additional Banking Entity Requirements.* 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 (c)(15)(i)(C)(*1*)(*iii*) of this section would be permissible for the banking entity to acquire and hold directly.

(v) *Investment and Relationship Limits.* 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, 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(l)–1; and

(B) Does not engage in any activity that would constitute proprietary trading under § 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), 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, 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 which is 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:

(*1*) 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. Amend § 44.12 by:
■ a. Revising paragraph (b)(1)(ii);
■ b. Revising paragraph (b)(4);
■ c. Adding paragraph (b)(5);
■ d. Revising paragraph (c)(1); and
■ e. Revising paragraphs (d) and (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)), 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)), 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)), 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) *Extension Period.* 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) *Application Requirements.* 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. Amend § 44.13 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 § 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. Amend § 44.14 by:

■ a. Revising paragraph (a)(2)(i);

■ b. Revising paragraph (a)(2)(ii)(C);

■ c. Adding paragraphs (a)(2)(iii), (a)(2)(iv); and (a)(3); 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;

(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 § 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 § 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.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE

12 CFR Chapter II

Authority and Issuance

For the reasons stated in the Common Preamble, the Board proposes to amend chapter I of Title 12, Code of Federal Regulations as follows:

PART 248—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS (Regulation VV)

■ 7. The authority citation for part 248 continues to read as follows:

Authority: 12 U.S.C. 1851, 12 U.S.C. 221 *et seq.,* 12 U.S.C. 1818, 12 U.S.C. 1841 *et seq.,* and 12 U.S.C. 3103 *et seq.*

Subpart B—Proprietary Trading

■ 8. Amend § 248.6 by adding paragraph (f) to read as follows:

§ 248.6 Other permitted proprietary trading activities.

* * * * *

(f) *Permitted trading activities of qualifying foreign excluded funds.* The prohibition contained in § 248.3(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 § 248.13(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

■ 9. Amend § 248.10 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:

§ 248.10 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 § 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 § 248.4(a)(3)) 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 advisor, 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 § 248.2(t);

(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) of this section, 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 § 248.2(t);

(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:

(*1*) 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) of this section 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 § 248.3(b)(l)(i), 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 § 248.11(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) *Additional Banking Entity Requirements.* 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)(*1*)(*iii*) of this section would be permissible for the banking entity to acquire and hold directly.

(v) *Investment and Relationship Limits.* A banking entity's investment in, and relationship with, the issuer must:

(A) Comply with the limitations imposed in §§ 248.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 248.15, 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(l)–1; and

(B) Does not engage in any activity that would constitute proprietary trading under § 248.3(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 § 248.11 (a)(8), 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 §§ 248.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 248.15, 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 § 248.11(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 §§ 248.14(b) and 248.15, 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 § 248.11(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 §§ 248.14(b) and 248.15, 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 which is 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:

(*1*) 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 § 248.12 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).

■ 10. Amend § 248.12 by:
■ a. Revising paragraph (b)(1)(ii);
■ b. Revising paragraph (b)(4);
■ c. Adding paragraph (b)(5);
■ d. Revising paragraph (c)(1); and
■ e. Revising paragraphs (d) and (e).

The revisions and addition read as follows:

§ 248.12 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 § 248.10(c)(1) 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 § 248.11 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 § 248.10(d)(6)(ii)), 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 § 248.10(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 § 248.10(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) *Extension Period.* 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) *Application Requirements.* 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.

■ 11. Amend § 248.13 by adding paragraph (d) to read as follows:

§ 248.13 Other permitted covered fund activities and investments.

* * * * *

(d) *Permitted covered fund activities and investments of qualifying foreign excluded funds.* (1) The prohibition contained in § 248.10(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 § 248.13(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.

■ 12. Amend § 248.14 by:

■ a. Revising paragraph (a)(2)(i);

■ b. Revising paragraph (a)(2)(ii)(C);

■ c. Adding paragraphs (a)(2)(iii), (a)(2)(iv); and (a)(3); and

■ d. Revising paragraph (c).

The revisions and additions read as follows:

§ 248.14 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 §§ 248.11, 248.12, or 248.13;

(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 § 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 § 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 § 248.15.

* * * * *

(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.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 351

Authority and Issuance

For the reasons set forth in the Common Preamble, the Federal Deposit Insurance Corporation proposes to amend chapter III of Title 12, Code of Federal Regulations as follows:

PART 351—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 13. The authority citation for part 351 continues to read as follows:

Authority: 12 U.S.C. 1851; 1811 *et seq.;* 3101 *et seq.;* and 5412.

Subpart B—Proprietary Trading

■ 14. Amend § 351.6 by adding paragraph (f) to read as follows:

§ 351.6 Other permitted proprietary trading activities.

* * * * *

(f) *Permitted trading activities of qualifying foreign excluded funds.* The prohibition contained in § 351.3(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 § 351.13(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

■ 15. Amend § 351.10 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:

§ 351.10 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 § 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 § 351.4(a)(3)) 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 advisor, 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 § 351.2(t);

(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) of this section, 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 § 351.2(t);

(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:

(*1*) 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) of this section 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 § 351.3(b)(l)(i) of subpart A of this part, 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 § 351.11(a)(8), 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) *Additional Banking Entity Requirements.* 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)(*1*)(*iii*) of this section would be permissible for the banking entity to acquire and hold directly.

(v) *Investment and Relationship Limits.* A banking entity's investment in, and relationship with, the issuer must:

(A) Comply with the limitations imposed in §§ 351.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 351.15, 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(l)–1; and

(B) Does not engage in any activity that would constitute proprietary trading under § 351.3(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 § 351.11(a)(8), 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 §§ 351.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 351.15, 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 § 351.11(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 §§ 351.14(b) and 351.15, 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 § 351.11(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 §§ 351.14(b) and 351.15, 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 which is 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:

(*1*) 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 § 351.12 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).

■ 16. Amend § 351.12 by:

■ a. Revising paragraph (b)(1)(ii);

■ b. Revising paragraph (b)(4);

■ c. Adding paragraph (b)(5);

■ d. Revising paragraph (c)(1); and

■ e. Revising paragraphs (d) and (e).

The revisions and addition read as follows:

§ 351.12 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 § 351.10(c)(1) 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 § 351.11 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 § 351.10(d)(6)(ii)), 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 § 351.10(d)(6)(ii)), 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 § 351.10(d)(6)(ii)), 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) *Extension Period.* 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) *Application Requirements.* 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.

■ 17. Amend § 351.13 by adding paragraph (d) to read as follows:

§ 351.13 Other permitted covered fund activities and investments.

* * * * *

(d) *Permitted covered fund activities and investments of qualifying foreign excluded funds.* (1) The prohibition contained in § 351.10(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 § 351.13(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.

■ 18. Amend § 351.14 by:

■ a. Revising paragraph (a)(2)(i);

■ b. Revising paragraph (a)(2)(ii)(C);

■ c. Adding paragraphs (a)(2)(iii), (a)(2)(iv); and (a)(3); and

■ d. Revising paragraph (c).

The revisions and additions read as follows:

§ 351.14 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 §§ 351.11, 351.12, or 351.13;

(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 § 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 § 351.15 of this section.

* * * * *

(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.

COMMODITY FUTURES TRADING COMMISSION

17 CFR Chapter I

Authority and Issuance

For the reasons set forth in the Common Preamble, the Commodity Futures Trading Commission proposes to amend part 75 to chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 75—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 19. The authority citation for part 75 continues to read as follows:

Authority: 12 U.S.C. 1851.

Subpart B—Proprietary Trading

■ 20. Amend § 75.6 by adding paragraph (f) to read as follows:

§ 75.6 Other permitted proprietary trading activities.

* * * * *

(f) *Permitted trading activities of qualifying foreign excluded funds.* The prohibition contained in § 75.3(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 § 75.13(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

■ 21. Amend § 75.10 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:

§ 75.10 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 § 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 § 75.4(a)(3)) 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 advisor, 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 § 75.2(t);

(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) of this section, 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 § 75.2(t);

(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:

(*1*) 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) of this section 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 § 75.3(b)(l)(i), 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 § 75.11(a)(8), 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) *Additional Banking Entity Requirements.* 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)(*1*)(*iii*) of this section would be permissible for the banking entity to acquire and hold directly.

(v) *Investment and Relationship Limits.* A banking entity's investment in, and relationship with, the issuer must:

(A) Comply with the limitations imposed in §§ 75.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 75.15, 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(l)–1; and

(B) Does not engage in any activity that would constitute proprietary trading under § 75.3(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 § 75.11 (a)(8), 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 §§ 75.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 75.15, 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 § 75.11(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 §§ 75.14(b) and 75.15, 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 § 75.11(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 §§ 75.14(b) and 75.15, 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 which is 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:

(*1*) 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 § 75.12 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).

■ 22. Amend § 75.12 is amended by:
■ a. Revising paragraph (b)(1)(ii);
■ b. Revising paragraph (b)(4);
■ c. Adding paragraph (b)(5);
■ d. Revising paragraph (c)(1); and
■ e. Revising paragraph (d) and (e).

The revisions and addition read as follows:

§ 75.12 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 § 75.10(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 § 75.11 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 § 75.10(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 § 75.10(d)(6)(ii)), 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 § 75.10(d)(6)(ii)), 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) *Extension Period.* 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) *Application Requirements.* 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.

■ 23. In subpart C, section 75.13 is amended by adding paragraph (d) to read as follows:

§ 75.13 Other permitted covered fund activities and investments.

* * * * *

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

(1) The prohibition contained in § 75.10(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 § 75.13(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.

■ 24. Amend § 75.14 by:

■ a. Revising paragraph (a)(2)(i);

■ b. Revising paragraph (a)(2)(ii)(C);

■ c. Adding paragraphs (a)(2)(iii), (a)(2)(iv); and (a)(3); and

■ d. Revising paragraph (c).

The revisions and additions read as follows:

§ 75.14 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 §§ 75.11, 75.12, or 75.13;

(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 § 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 § 75.15.

* * * * *

(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.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Chapter II

Authority and Issuance

For the reasons set forth in the Common Preamble, the Securities and Exchange Commission proposes to amend part 255 to chapter II of Title 17 of the Code of Federal Regulations as follows:

PART 255—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 25. The authority citation for part 255 continues to read as follows:

Authority: 12 U.S.C. 1851.

Subpart B—Proprietary Trading

■ 26. Amend § 255.6 by adding paragraph (f) to read as follows:

§ 255.6 Other permitted proprietary trading activities.

* * * * *

(f) *Permitted trading activities of qualifying foreign excluded funds.* The prohibition contained in § 255.3(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 § 255.13(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

■ 27. Amend § 255.10 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:

§ 255.10 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 § 255.4(a)(3)) 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 advisor, 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 § 255.2(t);

(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) of this section, 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 § 255.2(t);

(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:

(*1*) 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) of this section 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 § 255.3(b)(l)(i) of subpart A of this part, 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 § 255.11(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) *Additional Banking Entity Requirements.* 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)(*1*)(*iii*) of this section would be permissible for the banking entity to acquire and hold directly.

(v) *Investment and Relationship Limits.* A banking entity's investment in, and relationship with, the issuer must:

(A) Comply with the limitations imposed in §§ 255.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 255.15, 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(*l*)–1; and

(B) Does not engage in any activity that would constitute proprietary trading under § 255.3(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 § 255.11(a)(8), 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 §§ 255.14 (except the banking entity may acquire and retain any ownership interest in the issuer) and 255.15, 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 § 255.11(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 §§ 255.14(b) and 255.15, 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 § 255.11(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 §§ 255.14(b) and 255.15, 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 which is 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:

(*1*) 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 § 255.12 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).

■ 28. Amend § 255.12 by:
■ a. Revising paragraph (b)(1)(ii);
■ b. Revising paragraph (b)(4);
■ c. Adding paragraph (b)(5);
■ d. Revising paragraph (c)(1); and
■ e. Revising paragraphs (d) and (e).

The revisions and addition read as follows:

§ 255.12 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 § 255.10(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 § 255.11 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 § 255.10(d)(6)(ii)), 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 § 255.10(d)(6)(ii)), 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 § 255.10(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) *Extension Period.* 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) *Application Requirements.* 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.

■ 29. Amend § 255.13 by adding paragraph (d) to read as follows:

§ 255.13 Other permitted covered fund activities and investments.

* * * * *

(d) *Permitted covered fund activities and investments of qualifying foreign excluded funds.* (1) The prohibition contained in § 255.10(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 § 255.13(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.

■ 30. Amend § 255.14 by:

■ a. Revising paragraph (a)(2)(i);

■ b. Revising paragraph (a)(2)(ii)(C);

■ c. Adding paragraphs (a)(2)(iii), (a)(2)(iv); and (a)(3); and

■ d. Revising paragraph (c).

The revisions and additions read as follows:

§ 255.14 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 §§ 255.11, 255.12, or 255.13;

(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 § 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 § 255.15 of this section.

* * * * *

(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.

Dated: January 29, 2020.

Joseph M. Otting,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, January 30, 2020.

Ann E. Misback,

Secretary of the Board.

Federal Deposit Insurance Corporation.

By order of the Board of Directors.

Dated at Washington, DC, on January 30, 2020.

Annmarie H. Boyd,

Assistant Executive Secretary.

Issued in Washington, DC, on February 3, 2020 by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

By the Securities and Exchange Commission.

Dated: January 30, 2020.

Eduardo A. Aleman,

Deputy Secretary.

Note: *The following appendices will not appear in the Code of Federal Regulations.*

Appendices to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds—CFTC Voting Summary and CFTC Commissioners' Statements

Appendix 1—CFTC Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative. The document submitted to the CFTC Commissioners for a vote did not include Section IV.F. SEC Economic Analysis.

Appendix 2—Dissenting Statement of CFTC Commissioner Rostin Behnam

I respectfully dissent as to the Commission's decision to propose more revisions to the Volcker Rule. The Volcker Rule, in simple terms, contains two basic prohibitions for banking entities: (1) They may not engage in proprietary trading; and (2) they cannot have an ownership interest in, sponsor, or have certain relationships with a covered fund. Last September, the Commission, along with other Federal agencies,[1] approved changes that significantly weakened the prohibition on propriety trading by narrowing the scope of financial instruments subject to the Volcker Rule.[2] Today, the Commission and the other agencies take aim at the second prohibition, and propose to significantly weaken the prohibition on ownership of covered funds. When the agencies approved the changes on proprietary trading in September, the late Paul Volcker himself sent a letter to the Chairman of the Federal Reserve stating that the amended rule ''amplifies risk in the financial system, increases moral hazard and erodes protections against conflicts of interest that were so glaringly on display during the last crisis.'' [3] I can imagine that he would say something very similar about the further changes that we propose today, particularly the erosion of the existing protections regarding conflicts of interest. I fear that, if we continue to roll back the Volcker Rule, we will soon reach a stage where, sadly, there is nothing left.

Appendix 3—Dissenting Statement of CFTC Commissioner Dan M. Berkovitz

Let's start by calling the Volcker Covered Fund Proposal (''Proposal'') what it is: A regulatory rollback.[4] Virtually every change in the Proposal creates a new exclusion from the rules, or eliminates or reduces existing requirements. The changes to the regulations run counter to the statutory purpose of prohibiting banks from owning hedge funds and private equity funds. The Proposal fails to analyze or discuss the risks inherent in the banking activities it would permit. It presents a thin veneer of a rationale for many of the changes that were precipitated by complaints from the banking industry. The agencies should be making reasoned decisions to improve the effectiveness of the regulations for the purposes mandated by Congress, not implementing industry-driven rollbacks. I therefore dissent.

The general purpose of the Volcker Rule is to eliminate excessive risk taking by banks that enjoy the benefits of U.S. taxpayer support while still preserving their ability to undertake banking activities that serve the public interest.[5] The covered fund provisions are intended to prevent banking entities from circumventing the proprietary trading prohibition in the Volcker rule through covered fund investments and limit bank involvement in covered funds so that the banks are not expected to bail out the funds if they lose money.[6]

While a few of the proposed changes are consistent with this statutory purpose because they correct unintended consequences from the original regulation, the Proposal goes much further than reasonably necessary and appears to create substantial loopholes without effectively analyzing the potential risks. There is no quantitative analysis of those risks. The rationales provided to support these rollbacks are qualitative, legalistic, and summary in nature. They purport to provide ''clarity,'' allow banks to ''diversify'' investments, or improve bank competitiveness—none of which advance the goals articulated by Congress.

I am concerned that the proposed changes, along with the other regulatory reductions implemented in the proprietary trading provisions of the Volcker regulations in November 2019,[7] may together substantially reduce the safety measures instituted in the Dodd-Frank Act. Are the large banks that are subject to Volcker profitable? Definitely. Are the banks less competitive as compared to their international competitors? No.[8] Do we need to give them more rein to take on more risk? A case for that has not been made. I fear that we are putting the United States taxpayer at risk of once again bailing out the banks when we as regulators fail to take a reasoned, thoughtful approach; one that seeks to reach an appropriate balance of free markets with regulatory guard rails for risk-taking. After all, the banks that are subject to the Volcker regulations are insured by the FDIC and/or have access to Federal Reserve Bank support. We should have a say in the risks they take when the U.S. taxpayer is standing behind them.

Specific Changes of Concern

Much of the Proposal addresses regulations that will not impact, or will have only indirect impacts on, the CFTC's core mandate to regulate the derivatives markets.

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[1] The Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; the Federal Deposit Insurance Corporation; and the Securities and Exchange Commission.

[2] 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).

[3] Jesse Hamilton and Yalman Onaran, ''Vocker the Man Blasts Volcker the Rule in Letter to Fed Chair,'' Bloomberg (Sep. 10, 2019), *https://www.bloomberg.com/news/articles/2019-09-10/volcker-the-man-blasts-volcker-the-rule-in-letter-to-fed-chair.*

[4] ''Rollback'' is defined as ''reduc[ing] (something, such as a commodity price) to or toward a previous level on a national scale.'' *https://www.merriam-webster.com/dictionary/rollback.*

[5] *See* Statement of Sen. Dodd, 156 Cong. Rec. S6242 (July 26, 2010) (''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.'').

[6] The classic example of this risk is the collapse of two Bear Stearns-sponsored hedge funds in 2007. Bear Stearns provided loans intended to shore up two Cayman Islands hedge funds established by Bear Stearns. Bear Stearns was not legally obligated to back the funds financially, but as a business matter, it felt compelled to support them because of its sponsorship of the funds. Those actions were part of a chain of events that eventually led to the fire sale of Bear Stearns to J.P. Morgan in March 2008. To entice J.P. Morgan to buy a distressed Bear Stearns, the Federal Reserve System provided financial support for the purchase. *See* Reuters, *Timeline: A dozen key dates in the demise of Bear Stearns* (Mar. 17, 2008), available at *https://www.reuters.com/article/us-bearstearns-chronology/timeline-a-dozen-key-dates-in-the-demise-of-bear-stearns-idUSN1724031920080317.*

[7] 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).

[8] U.S. banks are the strongest in the world. The recent Global League Tables ranking global banks by amount of banking business activity shows that three or four U.S. banks are in the top five banks in almost every category, including for banking business in foreign markets. *See GlobalCapital.com*, Global League Tables, available at *https://www.globalcapital.com/data/all-league-tables.*

Nonetheless, I cannot vote in favor of proposed regulations that are presented to this agency for review that broadly fail to follow congressional intent—limiting risky behavior by banks connected with hedge funds and private equity funds.

The Proposal states: ''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.'' [9] This benign façade masks the true purpose and effect of the Proposal, which is a regulatory rollback. It adds five new, substantive exclusions from covered funds regulation; [10] expands three existing and significant exclusions; reduces what constitutes ''ownership'' in a covered fund in numerous ways; and significantly reduces limitations on banking relationships with covered funds.

The Volcker covered fund provisions could benefit from tailored revisions to fix some unintended consequences. The so called ''super 23A'' provisions restrict regular bank clearing activities for certain covered funds for which an affiliate provides services, such as investment management. Clearing services are not risk-taking activities. As another example, the existing regulations inadvertently convert some foreign covered funds into banking entities subject to the entire rule set when the statute intended to exclude those activities if they take place outside the United States. The Proposal would properly address these issues. Unfortunately, it also goes much further in proposing regulatory reductions without careful consideration of the risks involved.

I will discuss three particular provisions to illustrate my concerns. First, the Proposal would exclude ''venture capital funds'' from the covered funds definition with some minor limitations that are not based on the risks involved. The Proposal acknowledges that, as stated in the final release for the current Volcker regulations, venture capital funds are private equity funds. The Proposal states that the venture capital fund exclusion is based in part on several statements by members of Congress regarding venture capital funds. However, a close reading of the four statements cited in the Proposal shows that three of the four do not call for a complete exclusion of venture capital funds. Congress could have excluded venture capital funds if that were the intent. It did not.

The justification for the broad venture capital fund exclusion is flimsy. The Proposal asserts the exclusion could ''promote and protect the safety and soundness of banking entities and the financial stability of the United States'' by allowing banks to ''diversify their permissible investment activities.'' [11] Unfortunately, virtually no analysis or information is provided as to whether such ''diversification'' is in fact a good thing. Allowing banks to invest in anything and everything would greatly increase diversification, but that absurd approach would not likely protect the safety and soundness of banks or our financial system.

A simple Google search reveals data indicating that venture capital investments historically have been high risk. One study found that about 75% of venture capital-backed firms in the United States did not return capital to investors.[12] A 2013 article in the Harvard Business Review noted that ''VC funds haven't significantly outperformed the public markets since the late 1990s, and since 1997 less cash has been returned to VC investors than they have invested.'' [13] The author goes on to note that ''[v]enture capital investments are generally perceived as high-risk and high-reward. The data in our report reveal that although investors in VC take on high fees, illiquidity, and risk, they rarely reap the reward of high returns.'' Although venture capital performs an important function in providing capital to new technologies, and has been critical in boosting our economy and global competitiveness, I do not think we should be permitting such investments by banks backed by U.S. taxpayers *without* analyzing the risks involved.

The Proposal would add another new exclusion from covered fund regulation for ''customer facilitation vehicles.'' This exclusion is concerning because it is not well defined and could potentially become an end run around the Volcker rule. In effect, a bank could be the counterparty for the instruments in the vehicle sold to customers and thereby take on substantial risks permitted as a result of the exclusion. These risks are not addressed in the Proposal.

The Proposal states that such funds or ''vehicles'' would be used to facilitate customer needs. The brief example given is of accommodating a bank customer that wants to purchase structured notes issued through a vehicle, not the bank, ''for certain legal, counterparty risk management, or accounting reasons specific to the customer.'' [14] However, unlike the ''credit fund exclusion,'' which limits the assets that may be held in such funds, the Proposal has no restrictions as to what instruments can be in the vehicle and whether the banking entity can be the counterparty for those instruments. A portfolio of complex derivatives or synthetic ''investments'' could be placed in the vehicle with the bank taking the other side of the trades.

Furthermore, the Proposal acknowledges that the so called ''customer facilitation'' vehicles can in fact be ginned up by the banks themselves and that ''marketing'' the vehicles to the customers is not restricted. In effect, a bank could now create a fund of investments that it wants to hold, put the underlying instruments into a ''vehicle'' and then market the other side of the investments to customers in the form of security ownership in the vehicle. This exclusion has the potential to create a large loophole for creative bankers to exploit.

Finally, there is a special exclusion created for billionaires: The new ''Family Wealth Management Vehicles'' exclusion. This provision would exclude so called ''family offices'' from Volcker covered funds regulation. Unlike the prior two examples, this exclusion is not likely to materially increase undesirable risk taking by banks.[15] Rather, it is concerning because it allows banks and wealth vehicles to avoid Volcker compliance. In my view, wealth vehicles for ultra-wealthy individuals do not need special regulatory relief.

As I noted recently in a statement opposing family office exemptions from several CFTC rules, family offices are not used by ordinary families who may have a modest degree of wealth. Rather, the extraordinarily wealthy—including hedge fund operators, bankers, and super wealthy entrepreneurs—create these organizations to preserve, grow, and pass on their wealth to their descendants.[16] According to the Global Family Office Report 2019, ''[t]he average family wealth of those surveyed for this report stands at USD 1.2 billion, while the average family office has USD 917 million in [assets under management].'' [17] The aggregate amount of wealth managed by family offices is staggering. By one estimate, the total assets under management by family offices is over $4 trillion, and the number of family offices has grown ten-fold in the last decade.[18] A recent Forbes article noted that ''[f]amily offices are now capable of making transactions that were traditionally reserved for big companies or private-equity firms and therefore are becoming a *disruptive force in the market-place.*'' [19]

Furthermore, there are indications that family offices for U.S. persons may be located

[9] Proposal, section II.

[10] While the Proposal lists four exclusions, the parallel investments permission is, in effect, an exclusion from regulation.

[11] Proposal, section III.C.2.

[12] Deborah Gage, *The Venture Capital Secret: 3 out of 4 Start-Ups Fail,* Wall Street Journal (Sept. 20, 2012), (citing research by Shikhar Ghosh, a senior lecturer at Harvard Business School), available at *https://www.wsj.com/articles/SB10000872396390443720204578004980476429190.*

[13] Diane Mulcahy, *Six Myths About Venture Capitalists,* Harvard Business Review (May 2013), available at *https://hbr.org/2013/05/six-myths-about-venture-capitalists.*

[14] Proposal, section III.C.4.

[15] The Proposal would only allow a de minimis investment in such vehicles by banking entities.

[16] Registration and Compliance Requirements for Commodity Pool Operators (CPOs) and Commodity Trading Advisors: Family Offices and Exempt CPOs, 84 FR 67355, 67369 (Dec. 10, 2019). According to one guide to family offices:

> [T]he modern concept of the family office developed in the 19th century. In 1838, the family of financier and art collector J.P. Morgan founded the House of Morgan to manage the family assets. In 1882, the Rockefellers founded their own family office, which is still in existence and provides services to other families.

EY Family Office Guide, *Pathway to successful family and wealth management,* at 4, available at *https://www.ey.com/en_us/tax/family-office-advisory-services.*

[17] Campden Research and UBS, *The Global Family Office Report 2019,* at 10, available at *https://www.ey.com/en_us/tax/family-office-advisory-services.*

[18] Francois Botha, *The Rise of the Family Office: Where Do They Go Beyond 2019?,* Forbes (Dec. 17, 2018), available at *https://www.forbes.com/sites/francoisbotha/2018/12/17/the-rise-of-the-family-office-where-do-they-go-beyond-2019/#426044f55795.*

[19] *Id* (emphasis added).

in offshore tax havens to avoid paying U.S. taxes.[20] Financial regulators should not provide special and favorable regulatory treatment to benefit those who seek to avoid paying their fair share of U.S. taxes.

[20] Kirby Rosplock, The Complete Family Office Handbook, A Guide for Affluent Families and the Advisors Who Serve Them, at 5 (Bloomberg Press 2014).

Conclusion

The Volcker Rule and related regulations are complicated. The regulations deserve careful, reasoned reassessment to maintain their effectiveness. Unfortunately, the Proposal is neither reasoned nor careful. It ignores the risk-reducing public policy for the Volcker rule and effectively acknowledges the fact that this rollback is driven by complaints from the very banks the rule is intended to make safer. No effort is made to assess the risks that the Proposal will now allow banks to assume. I cannot support the proposed changes to the Volcker rule because they do not conform to the statutory mandate for the rule and the Proposal does not carefully analyze the effect of the changes on the safety and soundness of our financial system. I therefore dissent.

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