

## Volcker Rule Reform Begins

### IN SHORT

**The Situation:** The Volcker Rule's complexity has created uncertainty and compliance burdens that adversely affect market liquidity, risk hedging, and other economically important activities.

**The Opportunities:** Bank regulators recently issued guidance to alleviate specific Volcker Rule issues and a request for public comment on revising and improving the Volcker Rule regulations.

**What to Do:** Market participants, including asset-backed issuers, should take advantage of the new regulatory guidance on foreign excluded funds and seeded covered funds, and they should provide specific facts and supporting data to the OCC on ways to improve the Volcker Rule regulations.

Section 13 of the Bank Holding Company Act of 1956 and related regulations ("Volcker Rule") prohibit banks and their affiliates ("banking entities") from engaging in "proprietary trading" and from sponsoring, acquiring, or retaining an ownership interest in most hedge funds and private equity funds ("covered funds").

In June 2017, the U.S. Treasury Department published a report ("[Treasury Report](#)") describing the Volcker Rule as "extraordinarily complex and burdensome" and recommended changes. The Treasury Report and several studies indicate that the Volcker Rule has adversely affected market liquidity and banking entities' risk hedging. Federal bank regulators ("Agencies") have recently begun to clarify and reform the Volcker Rule regulations.



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### Temporary Relief for Foreign Excluded Funds

The Agencies issued a July 21, 2017, [statement](#) regarding certain foreign funds. Funds organized and offered exclusively outside the United States by a foreign banking entity ("foreign excluded fund") are not "covered funds." A foreign excluded fund may become a "banking entity" subject to the Volcker Rule if it is controlled by a banking entity. A number of market participants, foreign governments, and others have noted this unintended consequence and have urged the Agencies to clarify the Volcker Rule regulations.

The Agencies will take no action for one year against a foreign banking entity based on attribution of a "qualifying foreign excluded fund" to the foreign banking entity, or against a qualifying foreign excluded fund as a banking entity. The no-action applies where any ownership interest in, or sponsorship of, the qualifying foreign excluded fund otherwise would be a permitted covered fund activity or investment conducted solely outside of the United States. This is known as the "SOTUS" exemption.

Reg. VV, §248.13(b) permits a foreign banking entity to rely on the SOTUS exemption if:

- The foreign banking entity's personnel making the decision to sponsor or invest in the fund are not located in the United States;
- The investment or sponsorship by the foreign banking entity is not accounted for by a branch or an affiliate in the United States; and
- The financing of the investment does not come from a U.S. branch or affiliate of the foreign banking entity.

The Agencies' relief excludes unsafe, unsound, or illegal activities. Legislation may be needed to effect a permanent solution.

## Extending Covered Funds' Seeding Period

The Federal Reserve issued [procedures](#) for extensions of the one-year seeding period for banking entities to invest in certain covered funds, including asset-backed securities' issuing entities.

The exemptions require a banking entity to reduce its permitted investment in a covered fund to 3 percent or less of the total outstanding ownership interests in the fund after a one-year seeding period, the "per-fund limitation."

The Federal Reserve will consider a number of factors under Reg. VV, § 248.12(e), including:

- Whether the investment creates a material exposure to high-risk assets or trading strategies;
- The risks and costs of maintaining versus disposing of the investment;
- Whether the investment or its divestiture would raise material conflicts of interest, including to customers or counterparties that are owed a duty;
- Market conditions; and
- Whether the plan is consistent with safety and soundness and the public interest.

Extension requests should be submitted at least 90 days prior to the expiration of the initial seeding period.

## OCC Seeks Public Comment on the Volcker Rule

The OCC issued a notice on August 2, 2017 ("Notice"), seeking comments on how the Volcker Rule's regulations "should be revised to better accomplish the purposes of the statute ... while decreasing the compliance burden on banking entities and fostering economic growth." The Notice also seeks comment on improvements in the application of the Volcker Rule, with or without revisions to the regulations. The Notice outlines these areas for consideration:

- The scope of entities subject to the regulation, including foreign and small entities;
- Proprietary trading restrictions;
- Covered funds restrictions; and
- Compliance programs and reporting requirements.

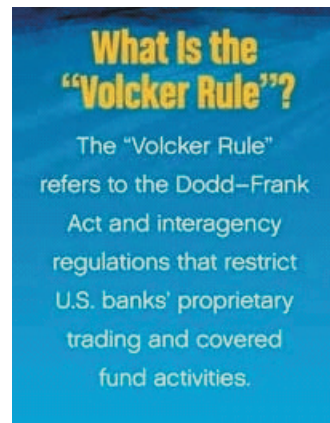
Comments are due 45 days after the Notice is published in the *Federal Register*.

## Possible Volcker Rule Revisions

The Financial Stability Oversight Council met on July 28, 2017, to consider the Treasury Report's Volcker Rule recommendations. It was [reported](#) that the responsible Volcker Rule agencies had agreed to rewrite the regulations to give banks "more flexibility for handling client trades, as well as investments in private equity and hedge funds."

### THREE KEY TAKEAWAYS

1. The Treasury Department and the bank regulators officially are recognizing the complexity and unintended adverse affects of the Volcker Rule regulations.
2. New guidance is being issued on specific topics in the highest volume since the Volcker Rule regulations were adopted in December 2013.
3. Rewriting of the regulations within the constraint of BHC Act Section 13 may be possible, and factual support for such changes is needed in responses to the OCC's Notice. Certain issues may require legislative solutions.



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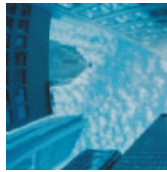
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