DEPARTMENT OF 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-[]; File no. S7-[]-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: Final rule.

SUMMARY: The OCC, Board, FDIC, SEC, and CFTC (together, the agencies) are adopting amendments to 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 (covered funds). These final amendments are intended to improve and streamline the regulations implementing section

13 of the BHC Act by modifying and clarifying requirements related to the covered fund provisions of the rules.

DATES: *Effective date*: The final rule is effective October 1, 2020.

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, Brendan Rowan, Senior Financial Institution Policy Analyst, (202) 475-6685, Christopher Powell, Senior Financial Institution Policy Analyst, (202) 452-3442, Nathaniel Grant, Lead Financial Institution Policy Analyst, (202) 452-3105, David McArthur, Senior Economist, (202) 452-2985, 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, Benjamin J. Klein, Counsel, bklein@fdic.gov, or Annmarie H. Boyd, Counsel, aboyd@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, 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: Juliet M. Han, Senior Counsel, William Miller, Senior Counsel, Benjamin A. Tecmire, Senior Counsel, or Jennifer Songer, Branch Chief at (202) 551-6787 or IArules@sec.gov, Investment Adviser Regulation Office, Division of Investment Management, and Katherine Hsu, Office Chief, or Benjamin Meeks, Special Counsel at (202) 551-3850, Office of Structured Finance, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background
II. Notice of Proposed Rulemaking
III. Overview of the Final Rule
IV. Summary of the Final Rule
- A. Qualifying Foreign Excluded Funds
- B. Modifications to Existing Covered Fund Exclusions
  - 1. Foreign Public Funds
  - 2. Loan Securitizations
  - 3. Public Welfare and Small Business Funds
- C. Additional Covered Fund Exclusions
  - 1. Credit Funds
  - 2. Venture Capital Funds
  - 3. Family Wealth Management Vehicles
  - 4. Customer Facilitation Vehicles
- D. Limitations on Relationships with a Covered Fund
- E. Ownership Interest
- F. Parallel Investments
- G. Technical Amendments

V. Administrative Law Matters
- A. Use of Plain Language

B. Paperwork Reduction Act
C. Regulatory Flexibility Act Analysis
D. Riegle Community Development and Regulatory Improvement Act
E. OCC Unfunded Mandates Reform Act
F. SEC Economic Analysis
G. Congressional Review Act

I. Background

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

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

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

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

[2] *Id.*

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

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

Authority under section 13 of the BHC Act for developing and adopting regulations to implement the prohibitions, restrictions, and exemptions of section 13 is shared among the Board, the FDIC, the OCC, the SEC, and the CFTC (individually, an agency, and collectively, the agencies).[5] The agencies originally issued a final rule implementing section 13 in December 2013 (the 2013 rule), and those provisions became effective on April 1, 2014.[6]

The agencies published a notice of proposed rulemaking in July 2018 (the 2018 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 trading activities. The agencies issued a

---

[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).

final rule implementing amendments to the 2013 rule in November 2019 (the 2019 amendments), and those provisions became effective in January 2020.[8]

As part of the 2018 proposal, the agencies proposed 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.[10] The agencies indicated they would issue a separate proposal addressing and requesting comment on the covered fund provisions of the rule and other fund-related issues, and, in February 2020, the agencies issued a separate notice of proposed rulemaking that specifically addressed those areas (the 2020 proposal).[11]

II. Notice of Proposed Rulemaking

In the 2020 proposal, the agencies proposed revisions to a number of the provisions regarding covered fund investments and activities as well as to other provisions of the implementing regulations related to the treatment of funds. The proposed changes, which were based on comments received in response to the agencies' questions in the 2018 proposal and the

---

[8] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 84 FR 61974 (Nov. 14, 2019). The regulations implementing section 13 of the BHC Act, as amended through June 1, 2020, are referred throughout as the "implementing regulations."

[9] 83 FR 33471–87.

[10] In response to the 2018 proposal, the agencies received numerous comments related to covered fund issues for which no specific rule text was proposed. However, in the preamble to the 2019 amendments, the agencies generally deferred public consideration of such comments to a future proposed rulemaking. 84 FR 62016.

[11] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 FR 12120 (Feb. 28, 2020).

agencies' experience with the implementing regulations, were intended to reduce the extraterritorial impact of the implementing regulations, improve and streamline the covered fund provisions, and provide clarity to banking entities regarding the provision of financial services and the conduct of 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 2020 proposal would have exempted 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. Under the 2013 rule, 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 U.S. covered funds, even though the foreign funds have limited nexus to the United States. Accordingly, the 2020 proposal would have codified an existing policy statement by the Federal banking agencies (the OCC, Board, and FDIC) that addresses the potential issues related to a foreign banking entity controlling qualifying foreign excluded funds.

The 2020 proposal also would have made 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 2020 proposal would have revised 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 2020 proposal would have permitted loan securitizations excluded from the definition of covered fund to hold a small amount of non-loan assets, consistent with past industry practice, and would have

codified existing staff-level guidance regarding this exclusion. In addition, the 2020 proposal would have revised the exclusion for small business investment companies to account for the life cycle of those companies and requested comment on whether to clarify the scope of the exclusion for public welfare and other investments to include rural business investment companies and qualified opportunity funds. Finally, the 2020 proposal would have addressed 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 also included in the 2020 proposal several new exclusions from the covered fund definition in order to more directly align the regulation with the purpose of the statute. For example, the agencies recognized that the implementing regulations have inhibited banking entities' ability to extend credit by restricting their relationships with credit funds, and the 2020 proposal would have created a new exclusion for such funds. Under the 2020 proposal, banking entities would have been 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 2020 proposal would have established an exclusion from the definition of covered fund for venture capital funds. This provision was intended to facilitate banking entities' abilities to 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. In addition, the agencies believed that excluding such activities would be consistent with the purpose of the statute, as it would exclude fund activities that do not present the risks that section 13 of the BHC Act was intended to address.

The 2020 proposal also would have allowed a banking entity to provide certain traditional financial services to its customers via a fund structure, subject to certain safeguards and limitations. First, the 2020 proposal would have excluded from the definition of covered fund an entity created and used to facilitate customer exposures to a transaction, investment strategy, or other service. Second, the 2020 proposal would have excluded from the covered fund definition wealth management vehicles that manage the investment portfolio of a family and certain other closely related persons. Both of these provisions were intended to allow a banking entity to provide such services in the manner best suited to its customers.

In addition, the 2020 proposal would have permitted a banking entity to engage in a limited set of covered transactions with a covered fund that 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, in the 2020 proposal, recognized 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.

Lastly, the 2020 proposal would have clarified 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 ownership interests. The 2020 proposal included a safe harbor for bona fide senior loans or senior debt instruments to make clear that an "ownership interest" in a fund would not include such credit interests in the fund. In addition, the 2020 proposal would have clarified the types of creditor rights that may attach to an interest without necessarily causing such an interest to fall within the scope of the definition of ownership interest. Finally, the 2020 proposal would have simplified compliance efforts by

tailoring the calculation of a banking entity's compliance with the implementing regulations' aggregate fund limit and covered fund deduction and provided clarity to banking entities regarding their permissible investments made alongside covered funds.[12]

The agencies invited comment on all aspects of the 2020 proposal, including specific proposed revisions and questions posed by the agencies. The agencies received approximately 40 unique comments from banking entities and industry groups, public interest groups, and other organizations and individuals. In addition, the agencies received six letters related to the subject matter considered in the 2020 proposal prior to the formal comment period. The agencies are now finalizing the 2020 proposal, with certain changes based on public comments, as described in detail below.[13]

---

[12] Separately, the agencies proposed various technical edits to the implementing regulations. *See infra* Section IV.G (Technical Amendments).

[13] Comments are generally discussed in the relevant sections, *infra*. The agencies also received several miscellaneous comments. One commenter suggested revising § __.21 (Termination of activities or investments; penalties for violations) of the implementing regulations to provide for mandatory prison time for violations of the implementing regulations. Anonymous. The agencies believe that this comment is beyond the scope of the current rulemaking. Another commenter encouraged the agencies to exempt from the implementing regulations international banks with a small presence in the United States. Institute of International Bankers (IIB). The agencies believe that this comment is beyond the scope of the current rulemaking. A third commenter claimed that the 2020 proposal improperly assumed that the implementing regulations have certain burdens and that it did not adequately assess the costs and benefits of the proposed revisions to the implementing regulations. Occupy the SEC (Occupy). Contrary to the commenter's suggestions, the Federal Register notice for the 2020 proposal contained extensive discussion of the costs and benefits of the 2020 proposal. *See* 85 FR 12151–76. This final rule contains similar analyses. *See infra*, Section IV (Administrative Law Matters). Several commenters expressed support for the comment letters submitted by other organizations. *E.g.*, IIB; European Banking Federation (EBF); Goldman Sachs Group, Inc. (Goldman Sachs); and Canadian Bankers Association (CBA). Finally, one comment was not relevant. *See* Charity Colleen Crouse.

III. Overview of the Final Rule

Similar to the 2020 proposal, the final rule clarifies and simplifies compliance with the implementing regulations, refines the extraterritorial application of section 13 of the BHC Act, and permits additional fund activities that do not present the risks that section 13 was intended to address. The agencies received comments from a diverse set of commenters: comments from banking entities and financial services industry trade groups were generally supportive of the 2020 proposal and recommended additional modifications, while several organizations and individuals were generally opposed to the 2020 proposal. As described further below, the agencies have adopted many of the proposed changes to the implementing regulations, with certain targeted adjustments.

To reduce the extraterritorial impact of the implementing regulations, the final rule, similar to the 2020 proposal, exempts the activities of certain funds that are organized outside of the United States and offered to foreign investors (qualifying foreign excluded funds) from certain restrictions of the implementing regulations. Specifically, the final rule codifies an existing policy statement by the Federal banking agencies that addresses the potential issues related to a foreign banking entity controlling a qualifying foreign excluded fund. The final rule contains some modifications to the proposed exemption – the anti-evasion provision and compliance program requirements – to address comments that the proposed exemption would have unintentionally continued to subject qualifying foreign excluded funds to these requirements.

The final rule also revises, as proposed, but with some modifications, several existing exclusions from the covered fund provisions, to provide clarity and simplify compliance with the requirements of the implementing regulations. First, the final rule revises 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 final rule permits loan securitizations excluded from the definition of covered fund to hold a small amount of debt securities, consistent with past industry practice, and codifies existing staff-level guidance regarding this exclusion. In addition, the final rule revises the exclusion for small business investment companies to account for the life cycle of those companies and clarifies the scope of the exclusion for public welfare and other investments to include rural business investment companies and qualified opportunity funds. Finally, the final rule clarifies the calculation of ownership interests in covered funds that are attributed to a banking entity.

The final rule adopts – as proposed, with some modifications – several new exclusions from the covered fund definition to more closely align the regulation with the purpose of the statute. First, the final rule establishes a new exclusion for funds that extend credit to permit the same credit-related activities that banking entities can engage in directly. In addition, the final rule creates an exclusion for venture capital funds to help ensure that banking entities can indirectly facilitate this important type of development and investment activity to the same degree that banking entities can do so directly. Finally, the final rule adopts two exclusions for family wealth management and customer facilitation vehicles to provide banking entities flexibility to provide advisory and other traditional banking services to customers through a fund structure.

In an effort to clarify and simplify compliance with the implementing regulations, the final rule adopts revisions to the provisions that govern the relationship between a banking entity and a fund and the definition of ownership interest. Specifically, the final rule permits established, codified categories of limited low-risk transactions between a banking entity and a

related fund, including riskless principal transactions, and allows a banking entity to engage in certain transactions with a related fund in connection with payment, clearing, and settlement activities. In addition, the final rule would provide an express safe harbor for senior loans and senior debt and provide clarity about the types of creditor rights that would be considered within the scope of the definition of ownership interest. Finally, the agencies are adopting revisions, as proposed, to provide clarity regarding a banking entity's permissible investments in the same investments as a covered fund organized or offered by such banking entity.

Frequently Asked Questions

The staffs of the agencies have addressed several questions concerning the implementing regulations through a series of staff Frequently Asked Questions (FAQs).[14] In the 2020 proposal, the agencies indicated that the proposed rule would not modify or revoke any previously issued staff FAQs, unless otherwise specified.[15] Several commenters recommended codifying specific FAQs and making explicit that other FAQs would continue to be in effect, unmodified.[16] Consistent with the 2020 proposal and commenters' suggestions, the final rule does not modify or revoke any previously issued staff FAQs, unless otherwise specified.[17]

Comment Period

---

[14] *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_VolckerRule/index.htm (CFTC).

[15] 85 FR 12122–23.

[16] *E.g.*, Securities Industry and Financial Markets Association (SIFMA); Financial Services Forum (FSF); and IIB.

[17] 85 FR 12122–23.

Since the issuance of the 2020 proposal, the COVID-19 global pandemic has substantially disrupted activity in the United States and in other countries. The effects of the COVID-19 disruptions have created many challenges for households and businesses, and the agencies received comments requesting that the agencies extend the comment period for the 2020 proposal or delay the rulemaking more generally.[18] In contrast, one commenter expressed support for the rapid approval of the 2020 proposal, to provide banking entities regulatory relief during a period of financial stress.[19] The agencies announced on April 2, 2020, that they would consider comments submitted before May 1, 2020.[20] The agencies, however, do not believe that further delay of the rule is warranted, given the volume, depth, and diversity of comments submitted. The agencies believe, as well, that the final rule may provide clarity to banking entities that will enable banking entities to engage in financial services and other permissible activities in a manner that both is consistent with the requirements of section 13 of the BHC Act and will facilitate capital formation and economic activity.

Effective and Compliance Dates

The Federal Register notice accompanying the finalization of the 2019 amendments provided for a rolling compliance system.[21] The effective date of the amendments was January 1, 2020, and firms are required to comply with the revisions by January 1, 2021. Until the mandatory compliance date, banking entities are required to comply with the 2013 rule, or

---

[18] *E.g.*, Better Markets, Inc. (Better Markets) and Kathy Bowman.

[19] American Bankers Association (ABA).

[20] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200402a.htm.

[21] 84 FR 61974.

alternatively, a banking entity may voluntarily comply, in whole or in part, with the 2019 amendments prior to the compliance date.

Several commenters on the 2020 proposal suggested that the agencies provide for voluntary early compliance with the final rule.[22] One commenter also suggested establishing a transition period of at least one year.[23]

The effective date for the final rule will be October 1, 2020, to accommodate the requirements of the Riegle Community Development and Regulatory Improvement Act.[24] The agencies do not believe an extended compliance or transition period is necessary because the final rule largely tailors the regulations implementing section 13 of the BHC Act rather than increases compliance burdens.

IV. Summary of the Final Rule

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 concerns 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).[25] 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

---

[22] *E.g.*, SIFMA; FSF; Japanese Bankers Association (JBA); and ABA.

[23] JBA.

[24] *See infra*, Section V.D (Riegle Community Development and Regulatory Improvement Act).

[25] The implementing regulations generally exclude 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.

majority of the fund's directors or trustees, or the foreign banking entity otherwise controls the fund for purposes of section 13 of the BHC Act. 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 policy statement), to address concerns about the possible unintended consequences and extraterritorial impact of section 13 and the implementing regulations for foreign excluded funds.[26] The policy statement noted that the Federal banking agencies would not take action against a foreign banking entity[27] 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, for a period of one year while staffs of the agencies considered alternative ways in which the implementing regulations could be amended, or other appropriate action could be taken, to address the issue. The policy statement has since been extended and is currently scheduled to expire on July 21, 2021.[28]

For purposes of the policy statement, a "qualifying foreign excluded fund" means, with respect to a foreign banking entity, an entity that:

---

[26] 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.

[27] "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. *Id.*

[28] 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.

(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 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 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 implementing regulations, as if the qualifying foreign excluded fund were a covered fund. To provide greater clarity and certainty to banking entities and qualifying foreign excluded funds, and to limit the extraterritoriality of the rule, the 2020 proposal included a permanent exemption from the section 13 restrictions on proprietary trading and investing in or sponsoring covered funds for the activities of qualifying foreign excluded funds. The proposed exemption generally included the same eligibility criteria from the policy statement, although it included a modified version of the anti-evasion provision such that, in order to qualify, a fund could not be operated in a manner

that enables "any other banking entity" (rather than "the foreign banking entity") to evade the requirements of section 13 or the implementing regulations.

The agencies requested comment on all aspects of this exemption. Commenters were generally supportive of the 2020 proposal to exempt qualifying foreign excluded funds from certain requirements of the implementing regulations.[29] Two commenters expressed opposition to the proposed exemption.[30]

Some commenters requested that qualifying foreign excluded funds be excluded from the definition of banking entity.[31] One commenter expressed concern that the 2020 proposal would require qualifying foreign excluded funds to establish section 13 of the BHC Act compliance programs, imposing costs on qualifying foreign excluded funds.[32] This commenter noted that there may be situations under section 13 of the BHC Act where a foreign banking entity controls a qualifying foreign excluded fund, but under foreign law does not have the necessary authority to require it to adopt a section 13 compliance program. As such, this commenter advocated for either excluding this type of fund from the definition of banking entity or exempting this type of fund from the compliance program requirements under the rule.[33] One commenter expressed concern that a qualifying foreign excluded fund would still need to comply with various

---

[29] SIFMA; Bank Policy Institute (BPI); Bundesverband Investment und Asset Management e.V. (BVI); American Investment Council (AIC); ABA; European Fund and Asset Management Association (EFAMA); Shareholder Advocacy Forum (SAF); IIB; JBA; CBA; and Credit Suisse.

[30] Occupy and Data Boiler Technologies LLC (Data Boiler).

[31] IIB; JBA; CBA; Credit Suisse; and EBF.

[32] JBA.

[33] JBA.

restrictions under section 13, including the provisions of § __.14 of the implementing regulations (i.e., Super 23A) and the compliance program requirements.[34]

Some commenters requested that the agencies change the anti-evasion provision of the qualifying foreign excluded funds definition so that it would only apply to the specific foreign banking entity, in a manner consistent with the policy statement.[35] One of these commenters suggested, as an alternative, revising the provision so that it would only apply to "any affiliated banking entities."[36]

One commenter requested an anti-evasion safe harbor and changes to allow a fund to be a qualifying foreign excluded fund when a non-U.S. banking entity serves as a management company to the fund and is approved to provide fund management in accordance with local law.[37] This commenter also requested that the agencies limit the requirements in the proposed qualifying foreign excluded funds definition to only those set forth in § __.13(b) of the rule for covered fund activities conducted by foreign banking entities solely outside the United States, and treat as qualifying foreign excluded funds those funds for which the foreign banking entity cannot exercise voting rights.

Pursuant to their authority under section 13(d)(1)(J) of the BHC Act, the agencies are adopting the exemption for the activities of qualifying foreign excluded funds substantially as proposed, but with modifications to the anti-evasion provision and compliance program requirements. Specifically, the agencies are exempting the activities of qualified foreign excluded funds from the restrictions on proprietary trading and investing in or sponsoring

---

[34] Credit Suisse.

[35] IIB; JBA; Credit Suisse; and EBF.

[36] Credit Suisse.

[37] JBA.

covered funds, if the acquisition or retention of the 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 conducted solely outside the United States, as provided in § __.13(b) of the rule.[38] Under the final rule, a qualifying foreign excluded fund has the same meaning as in the policy statement as described above and in the 2020 proposal, except for the modification to the anti-evasion provision, as described below.

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.[39] For the reasons described below, the agencies have determined that exempting the activities of qualifying foreign excluded funds promotes and protects the safety and soundness of banking entities and U.S. financial stability.

This relief is expected to promote and protect the safety and soundness of such funds and their foreign banking entity sponsors by putting them on a level playing field with their foreign competitors that are not subject to the implementing regulations. If the activities of these foreign funds were subject to the restrictions applicable to banking entities, their asset management activities could be significantly disrupted, and their foreign banking entity sponsors 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 allows 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

---

[38] *See* final rule § __.13(b).

[39] 12 U.S.C. 1851(d)(1)(J).

acquisition of an ownership interest in or sponsorship of the fund meets the requirements in § __.13(b) of the implementing regulations. Thus, the exemption is expected to 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 sections 13(d)(1)(H) and (I) of the BHC Act.

The exemption is also expected to promote and protect U.S. financial stability. While qualifying foreign excluded funds have a very limited nexus to the U.S. financial system, the exemption would promote U.S. financial stability by providing additional capital and liquidity to U.S. capital markets without a concomitant increase in risk borne by U.S. entities. Because the exemption requires that the foreign banking entity's acquisition of an ownership interest in or sponsorship of the fund meets the requirements in § __.13(b) of the final rule, the exemption will help ensure that the risks of investments made by these foreign funds will be booked at foreign entities in foreign jurisdictions, thus promoting and protecting U.S. financial stability. Additionally, subjecting such funds to the requirements of the implementing regulations could precipitate disruptions in foreign capital markets, which could generate spillover effects in the U.S. financial system.

In response to comments regarding the anti-evasion provision, the final rule specifies that the qualifying foreign excluded fund must not be operated in a manner that enables the banking entity that sponsors or controls the qualifying foreign excluded fund, or any other affiliated banking entity (other than a qualifying foreign excluded fund), to evade the requirements of section 13 of the BHC Act or the final rule. This change is meant to clarify the scope of the anti-evasion provision and provide certainty for banking entities that sponsor or control the qualifying foreign excluded fund.

Consistent with feedback from several commenters, the agencies also have modified compliance requirements with respect to qualifying foreign excluded funds. While, under the final rule, the activities of a qualifying foreign excluded fund are exempted from the proprietary trading restrictions of § __.3(a) and the covered fund restrictions of § __.10(a) of the final rule, the qualifying foreign excluded fund is still a banking entity. Absent any additional changes, the qualifying foreign excluded fund could become subject to the compliance requirements of § __.20. However, since these qualifying foreign excluded funds are exempted from the proprietary trading requirements of § __.3(a) and covered fund restrictions of § __.10(a) of the final rule, the agencies believe that requiring a compliance program for the fund itself is overly burdensome and unnecessary. The requirements in § __.20 are intended to ensure and monitor compliance with the proprietary trading and covered fund provisions, and there would be no benefit to applying these requirements to an entity that is exempt from those provisions. Therefore, under the final rule, qualifying foreign excluded funds are not required to have compliance programs or comply with the reporting and additional documentation requirements under § __.20. However, any banking entity that owns or sponsors a qualifying foreign excluded fund will still be required to have in place appropriate compliance programs for itself and its other subsidiaries and provide reports and additional documentation as required by § __.20.

The final rule does not amend the definition of "banking entity" as requested by several commenters. Because "banking entity" is specifically defined in section 13 of the BHC Act, the agencies find it appropriate to address concerns related to foreign excluded funds through their exemptive rulemaking authority.

The agencies are not making any change regarding the applicability of § __.14 of the implementing regulations, which imposes limitations on relationships with covered funds, with

respect to qualifying foreign excluded funds. The agencies believe it is appropriate to retain the application of § __.14 to qualifying foreign excluded funds to limit risks that may be borne by banking entities located in the United States through transactions with such funds.[40] Further, given the limited set of circumstances in which § __.14 would apply (i.e., a transaction between a foreign excluded fund and a covered fund that is sponsored or advised by the same banking entity), the agencies do not believe that it is overly burdensome for a banking entity that sponsors or controls a qualifying foreign excluded fund to ensure that it is not in violation of § __.14.

B. Modifications to Existing Covered Fund Exclusions

In the preamble to the 2013 rule, the agencies acknowledged that the covered fund definition was expansive.[41] To effectively tailor the covered fund provisions to the types of entities that section 13 of the BHC Act was intended to cover, the 2013 rule excluded various types of entities from the covered fund definition.[42] In response to comments received on the 2020 proposal, and based on experience implementing the rule, the agencies are modifying certain of the existing exclusions, as described below, to make them more appropriately structured to effectuate the intent of the statute and its implementing regulations.

1. Foreign Public Funds

2013 Rule

---

[40] A U.S. banking entity's exposure to a fund that would be a qualifying foreign excluded fund with respect to a foreign banking entity may still be a covered fund with respect to a U.S. banking entity under § __.10(b)(1)(iii) of the implementing regulations. A U.S. banking entity's investment in and relationship with such a fund could therefore be subject to the entirety of the applicable prohibitions and restrictions of Subpart C of the implementing regulations.

[41] *See* 79 FR 5677.

[42] *See id.*

To provide consistent treatment for U.S. registered investment companies and their foreign equivalents, the implementing regulations exclude foreign public funds from the definition of covered fund.[43] A foreign public fund is generally defined under the 2013 rule 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.[44] 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.[45] 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 only investors with 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.[46]

---

[43] 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. 79 FR 5678.

[44] 2013 rule § __.10(c)(1); *see also* 79 FR 5678.

[45] 79 FR 5678.

[46] 2013 rule § __.10(c)(1)(iii).

The 2013 rule places an additional condition on a U.S. banking entity's ability to rely on the foreign public fund exclusion with respect to any foreign fund it sponsors.[47] 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.[48] 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.[49]

2020 Proposal

In the 2020 proposal, the agencies acknowledged that some of the conditions of the 2013 rule's foreign public fund exclusion may not be necessary to ensure consistent treatment of foreign public funds and U.S. 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

---

[47] 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").

[48] *See* 2013 rule § __.10(c)(1)(ii).

[49] 79 FR 5678.

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.

To address these concerns, the 2020 proposal would have made certain modifications to the foreign public fund exclusion. First, the agencies proposed to replace the requirement that the fund be authorized to be offered and sold to retail investors in the issuer's home jurisdiction (the home jurisdiction requirement) and the requirement that the fund interests be sold predominantly through one or more public offerings outside of the United States, 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 outside of the United States. This change would have permitted foreign funds to qualify for the exclusion if they are organized in one jurisdiction but only authorized to be sold to retail investors in another jurisdiction, as this is a fairly common way for foreign retail funds to be organized. Also, no longer requiring a fund to be sold predominantly through one or more public offerings was intended to reduce the difficulty that banking entities have described in determining and monitoring the distribution history and patterns of a third-party sponsored fund or a sponsored fund whose interests are sold through third-party distributors.

The agencies also proposed modifying the definition of "public offering" from the implementing regulations to add a new requirement that the distribution be subject to substantive disclosure and retail investor protection laws or regulations, to help ensure that foreign funds qualifying for this exclusion are sufficiently similar to U.S. registered investment companies. Additionally, the 2020 proposal would have only applied 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 proposed change was 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.

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 2020 proposal would have eliminated 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 was intended to help 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 2020 proposal would have continued to limit the sale of ownership interests to directors or senior executive officers of the sponsoring banking entity or the issuer (or their affiliates), as the agencies believed that such a requirement would be simpler for a banking entity to track.

Finally, the 2020 proposal requested comment on the appropriateness of the expectation stated in the preamble to the 2013 rule that, for a U.S. banking entity-sponsored foreign fund to satisfy the condition that it be "predominantly" sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity, at least 85 percent of the ownership interests in the fund should be sold to such other persons.

Discussion of Comments and the Final Rule

The agencies are adopting all of the proposed changes and are making certain adjustments in response to comments received, as discussed below.

Commenters on the 2020 proposal generally supported the proposed changes to the foreign public funds exclusion.[50] Specifically, commenters supported the elimination of the home jurisdiction requirement and the requirement that the fund be sold predominantly through one or more public offerings.[51] Commenters supported the proposed change to the "public offering" definition to include a requirement that a distribution be subject to substantive disclosure and retail investor protection laws or regulations,[52] but did not recommend further specifying what substantive disclosure and investor protection requirements should apply because they generally viewed it as unnecessary and overly prescriptive.[53] Commenters also supported eliminating the restriction on share ownership by employees (other than senior executives and directors) of the U.S. banking entity that sponsors the foreign public fund.[54] In response to a specific question in the 2020 proposal, one commenter indicated that the proposed changes to the foreign public funds exclusion would not increase the risk of evasion of the requirements of section 13 and the implementing regulations, and thus no additional anti-evasion

---

[50] IIB; SIFMA; BPI; ABA; EBF; EFAMA; FSF; Investment Company Institute (ICI); BVI; CBA; Committee on Capital Markets Regulation (CCMR); Data Boiler; Goldman Sachs; Investment Adviser Association (IAA); JBA; SAF; and U.S. Chamber of Commerce Center for Capital Markets Competitiveness (CCMC).

[51] IIB; SIFMA; BPI; ABA; EBF; EFAMA; FSF; ICI; BVI; and CBA.

[52] IIB; EFAMA; FSF; ICI; and BVI.

[53] IIB; ICI; and CBA. One commenter supported this assertion by stating that 95 percent of the world's securities markets, including all major emerging markets, have substantive disclosure and retail investor protection rules that are guided by the International Organization of Securities Commissions' common principles for retail funds and the detailed policy work that informs those principles. ICI.

[54] FSF.

measures were necessary.[55] Another commenter stated that the proposed changes were less than ideal but were acceptable after balancing compliance costs and benefits.[56]

Commenters also recommended additional changes to further align the treatment of foreign public funds with that of U.S. registered investment companies or to prevent evasion of the rule.[57] Specifically, some commenters recommended eliminating the requirement that a fund actually be sold through a public offering and, instead, only require that a fund be authorized to be sold through a public offering.[58] These commenters generally viewed this requirement as burdensome and difficult to administer and noted that U.S. registered investment companies are not required to be sold in public distributions. The agencies do not consider the fact that there is no requirement for U.S. registered investment companies to be actually sold through public offerings as a sufficient rationale for removing this requirement from the foreign public fund exclusion. Requiring foreign public funds to be sold through one or more public offerings is intended to ensure that such funds are in fact public funds and thus sufficiently similar to U.S. registered investment companies. While there may be certain limited scenarios where a U.S. registered investment company is not sold to retail investors, the agencies believe that the vast majority of U.S. registered investment companies are sold to retail investors. Furthermore, U.S. registered investment companies are subject to robust registration, reporting, and other requirements that are familiar to the agencies, whereas foreign public funds are subject to a

---

[55] SIFMA.

[56] Data Boiler.

[57] One commenter recommended that the agencies create an exclusion from the "proprietary trading" definition for the activities of regulated funds, including foreign public funds, under certain circumstances. ICI. The agencies note that such a change is not within the scope of this rulemaking.

[58] IIB; SIFMA; and EBF.

differing array of requirements depending on the jurisdiction where they are authorized to be sold. These other jurisdictions may have less developed requirements for retail funds, which may increase the likelihood of a fund seeking authorization for public distribution in certain foreign jurisdictions solely as a means of avoiding the covered fund prohibition. The agencies believe that eliminating this requirement would increase the risk of evasion by permitting foreign funds that may be authorized for sale to retail investors in a foreign jurisdiction—but are only sold through private offerings where no substantive disclosure or retail investor protections exist—to qualify for the exclusion. Such funds would not be comparable to U.S. registered investment companies and would not be the type of fund that foreign public fund exclusion was intended to address. Accordingly, the agencies are not adopting this suggested modification.

One trade association commenter suggested eliminating a provision in the "public offering" requirement that prohibits a distribution from being limited to investors with a minimum net worth or net investment assets because some of its members distribute funds, including mutual funds, in offerings that do not meet this requirement but that are nonetheless subject to substantive disclosure and retail investor protection requirements. Similar to the reasons for retaining the requirement that a foreign public fund actually be sold through one or more public offerings, the agencies believe that retaining this requirement is necessary to ensure that funds qualifying for this exclusion are sufficiently similar to U.S. registered investment companies. In fact, one of the identifying characteristics of a covered fund is that its offerings are limited to investors with minimum net worth or net investment assets.[59] The agencies

[59] Under the Investment Company Act, certain funds whose offerings are limited to investors with minimum net worth or net investment assets are exempt from registration as investment companies. *See* 15 U.S.C. 80a-3(c)(7). These funds are generally treated as covered funds under section 13 of the BHC Act and the implementing regulations. *See* 12 U.S.C. 1851(h)(2); implementing regulations § __.10(b)(1)(i).

therefore believe that foreign funds that limit their offerings to investors with a minimum net worth or net investment assets are generally not sufficiently similar to U.S. registered investment companies, and thus the agencies are not adopting this suggested change to the "public offering" definition.

One commenter opposed the proposed elimination of the requirement in the "public offering" definition that a distribution comply with all applicable requirements in the jurisdiction in which such distribution is being made for a banking entity that does not serve as the fund's investment manager, investment adviser, commodity trading advisor, commodity pool operator, or sponsor.[60] The final rule adopts this modification as proposed, because the agencies believe the other eligibility criteria for a fund to qualify under the foreign public fund exclusion are sufficient to appropriately identify these funds. In addition, the agencies recognize that it may be difficult or impossible for a banking entity that invests in a third-party fund to know whether the fund's distribution complied with all applicable requirements in the jurisdiction where it was distributed.

One commenter recommended that the agencies require 85 percent of a foreign public fund's ownership interests be sold to and owned by "bona fide" retail investors in the fund's home jurisdiction.[61] However, for the same reasons that the agencies are eliminating the home jurisdiction requirement and the requirement that a fund be sold predominantly through public offerings, the agencies are not adopting this requirement.

---

[60] Data Boiler.

[61] Oleh Zadorestskyy. This commenter also suggested that the agencies require proof that the investors were non-U.S. persons.

Some commenters suggested that the agencies identify common foreign fund types that are presumed to qualify for the exclusion for foreign public funds for the purpose of improving efficiency and simplifying compliance with the rule.[62] Other commenters recommended that issuers listed on an internationally-recognized exchange and available in retail-level denominations should automatically qualify for the exclusion for similar reasons.[63] Although the agencies expect many such funds will qualify for the exclusion, the agencies decline to adopt either of these suggested changes, as both would require the agencies' review and on-going monitoring of foreign laws and regulations to ensure that the types of funds that would qualify under these provisions are sufficiently similar to U.S. registered investment companies and that their exclusion as foreign public funds would continue to be appropriate.

Some commenters recommended that the agencies entirely eliminate the restrictions on share ownership by parties affiliated with a U.S. banking entity sponsor of a foreign public fund.[64] Other commenters suggested that, if the restrictions on share ownership by banking entities affiliated with the sponsor were retained, the restrictions on share ownership by senior executives and directors should be removed.[65] The commenters generally viewed these requirements as unnecessary and burdensome to track and monitor. As discussed in the preamble to the 2013 rule, these requirements are intended to prevent evasion of section 13 of the BHC Act.[66] Additionally, the agencies note that U.S. banking entity sponsors of foreign

---

[62] IIB and EBF.

[63] IIB; SIFMA; BPI; ABA; FSF; and CBA.

[64] SIFMA and FSF.

[65] SIFMA; BPI; ICI; and CCMC.

[66] 79 FR 5678–79.

public funds would need to track the ownership of such funds by their affiliates and management officials even if the requirements were eliminated in order to determine whether they control such funds for BHC Act purposes.[67] Thus, for a U.S. banking entity relying on this exclusion with respect to a fund that it sponsors, the agencies are retaining the requirement that the fund be sold predominantly to persons other than the U.S. banking entity sponsor, the fund, affiliates of such sponsoring banking entity or fund, and the directors and senior executive officers of such entities (collectively, "U.S. banking entity sponsor and associated parties").

Relatedly, some commenters recommended that the agencies modify their expectation of the level of ownership of a foreign public fund that would satisfy the requirement that a fund be "predominantly" sold to persons other than its U.S. banking entity sponsor and associated parties,[68] which, in the preamble to the 2013 rule, the agencies stated was 85 percent or more (which would permit the U.S. banking entity sponsor and associated parties to own the remaining 15 percent). These commenters asserted that the relevant ownership threshold for U.S. registered investment companies is 25 percent, and that, for foreign public funds, the threshold should be the same. The agencies agree that the permitted ownership level of a foreign public fund by a U.S. banking entity sponsor and associated parties should be aligned with the functionally equivalent threshold for banking entity investments in U.S. registered investment companies, which is 24.9 percent.[69] Accordingly, the agencies have amended this provision in the final rule

---

[67] *See* 12 CFR 225.2(e); 12 CFR 225.31(d)(2)(ii). If a foreign public fund is controlled by a banking entity for BHC Act purposes, such fund could also be being treated as a banking entity under section 13. *See* implementing regulations § __.2(c); FAQ 14.

[68] BPI; FSF; ICI; and CCMC.

[69] Although the implementing regulations do not explicitly prohibit a banking entity from acquiring 25 percent or more of a U.S. registered investment company, a U.S. registered investment company would become a banking entity if it is affiliated with another banking entity (other than as described in § __.12(b)(1)(ii) of the implementing regulations). *See* 79 FR 5732

to require that more than 75 percent of the fund's interests be sold to persons other than the U.S. banking entity sponsor and associated parties.[70]

One commenter recommended that, with respect to foreign public funds sponsored by U.S. affiliates of foreign banking entities, the agencies exclude the sponsoring U.S. banking entity's non-U.S. affiliates and their directors and employees from the restrictions on share ownership, provided that such non-U.S. affiliates are not controlled by a U.S. banking entity.[71] This commenter asserted that there is no U.S. financial stability or safety and soundness benefit to applying this restriction to such non-U.S. affiliates and their directors and employees, as the risks of any such investments are borne solely outside the United States. However, with the change described above, which permits a U.S. banking entity sponsor and associated parties to hold less than 25 percent of a foreign public fund, the agencies do not believe that this change is necessary. Even if the requirement were modified as the commenter suggested, the banking entity and its affiliates would still be limited to owning less than 25 percent of the fund without the fund becoming a banking entity.

("[F]or purposes of section 13 of the BHC Act and the final rule, a registered investment company . . . will not be considered to be an affiliate of the banking entity if the banking entity owns, controls, or holds with the power to vote less than 25 percent of the voting shares of the company or fund, and provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund only in a manner that complies with other limitations under applicable regulation, order, or other authority.").

[70] For a U.S. banking entity that sponsors a foreign public fund, crossing the 24.9 percent ownership threshold (other than during a permitted seeding period) would cause the fund to be a covered fund (if no other exclusion applied), in which case the banking entity would be in violation of the 3 percent per-fund investment limit. *See* implementing regulations § __.12(a)(2)(ii)(A). The agencies believe that such a strict prohibition against a U.S. banking entity acquiring 25 percent or more of a foreign public fund that it sponsors is appropriate because of the elevated risk of evasion by the sponsoring banking entity, which may be able to control the investments made by the fund.

[71] IIB.

One commenter requested that the agencies modify § __.12(b)(1) of the implementing regulations, which governs attribution of ownership interests in covered funds to banking entities, to clarify that the banking entity "or an affiliate" can provide the advisory, administrative, or other services required in § __.12(b)(1)(ii)(B) for the non-attribution rule to apply. The commenter requested this clarification because § __.12(b)(1)(ii)(B) is cross-referenced by FAQ 14, which, as discussed above, states that a foreign public fund will not be treated as a banking entity if it complies with the test in § __.12(b)(1)(ii) (i.e., the banking entity holds less than 25 percent of the voting shares in the foreign public fund and provides advisory, administrative, or other services to the fund). The agencies confirm that the requested interpretation is correct and, accordingly, have amended § __.12(b)(1)(ii) of the implementing regulations to clarify that the ownership limit applies to the banking entity and its affiliates, in the aggregate, and the requirement that the banking entity provide advisory or other services can be satisfied by the banking entity or its affiliates.

One commenter noted that FAQ 16, which relates to the seeding period for foreign public funds, uses 3 years as an example of the duration of such a seeding period, and requested that the agencies confirm that a foreign public fund's seeding period can be longer than 3 years.[72] Another commenter requested that the agencies codify the 3-year seeding period in the implementing regulations.[73] The agencies believe that, depending on the facts and circumstances of a particular foreign public fund, the appropriate duration of its seeding period may vary and, under certain facts and circumstances, may exceed three years. The agencies believe that this flexibility is appropriate and thus decline to further specify such a limit. Another commenter

[72] IAA.

[73] CCMC.

requested that the agencies codify the foreign public fund seeding FAQ,[74] FAQ 14, and FAQ 16, both described above, in the implementing regulations.[75] The agencies decline to codify these FAQs at this time but note that the final rule does not modify or revoke any previously issued staff FAQs, unless otherwise specified.

In the final rule, the agencies are adopting the amendments to the foreign public funds exclusion as proposed, with the additional modifications described above. The agencies believe the revised requirements will make the foreign public fund exclusion more effective by expanding its availability, providing clarity, and simplifying compliance with its requirements, while continuing to ensure that the funds that qualify are sufficiently similar to U.S. registered investment companies.

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."[76] To effectuate this statutory mandate, the 2013 rule excluded from the definition of covered fund loan securitizations that issue asset-backed securities and hold only loans, certain rights and assets that arise from the structure of the loan securitization or from the loans supporting a loan securitization, and a small set of other financial instruments (permissible assets).[77]

---

[74] The foreign public fund seeding FAQ states that staffs of the agencies would not advise that a seeding vehicle that is operated pursuant to a written plan to become a foreign public fund and that meets certain conditions be treated as a covered fund during such seeding period.

[75] IIB.

[76] 12 U.S.C. 1851(g)(2).

[77] *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).

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. In the 2018 proposal, the agencies asked several questions regarding the efficacy and scope of the exclusion and the Loan Securitization Servicing FAQ.[78] Comments focused on permitting small amounts of non-loan assets and clarifying the treatment of leases and related assets.

In response to these concerns, the 2020 proposal would have codified the Loan Securitization Servicing FAQ and permitted loan securitizations to hold a small amount of non-loan assets. The agencies requested comment on all aspects of the proposed changes to the loan securitization exclusion, and comments were generally supportive of the proposed revisions.[79] Several commenters also suggested revisions to the 2020 proposal.[80] Comments are discussed in detail below.[81]

Servicing Assets

---

[78] 83 FR 33480–81.

[79] *E.g.*, SIFMA; BPI; Managed Funds Association (MFA); PNC Financial Services Group, Inc. (PNC); Goldman Sachs; Loan Syndications and Trading Association (LSTA); and Structured Finance Association (SFA).

[80] *E.g.*, SIFMA; CCMC; BPI; and IIB.

[81] One commenter suggested that some jurisdictions' risk retention rules may vary from the regulations implementing section 15G of the Exchange Act (15 U.S.C. 78o-11), which requires a banking entity to retain and maintain a certain minimum interest in certain asset-backed securities. *See* IIB. This commenter recommended allowing banking entities to hold certain investments in compliance with certain foreign laws (e.g., European risk retention rules). The agencies understand that rules for risk retention vary across jurisdictions. However, the agencies believe that the requested action is outside the scope of the current rulemaking. In addition, another commenter requested that the agencies clarify the definition of asset-backed securities as used in the loan securitization exclusions. *See* Arnold & Porter Kaye Scholer LLP (Arnold & Porter). The agencies discuss the definition of asset-backed securities in Section IV.C.1.iii (Credit Funds), *infra*.

The implementing regulations permit 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.[82] Rights or other servicing assets are assets designed to facilitate the servicing of the underlying loans or the distribution of proceeds from those loans to holders of the asset-backed securities.[83] In response to confusion regarding the scope of the provisions permitting servicing assets and a separate provision limiting the types of permitted securities, the staffs of the agencies released the Loan Securitization Servicing FAQ. The FAQ clarified that 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.

The 2020 proposal would have codified the Loan Securitization Servicing FAQ in the implementing regulations to clarify the scope of the servicing asset provision.[84] Commenters generally supported the codification of the Loan Securitization Servicing FAQ, indicating that such a codification would promote transparency and ensure continued use of the loan securitization exclusion.[85] For the above reasons, the final rule adopts the codification of the Loan Securitization Servicing FAQ as proposed.

Cash Equivalents

---

[82] §§ __.2(t); __.10(c)(8)(i)(D); __.10(c)(8)(v).

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

[84] The 2020 proposal also clarified 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. *See* 2020 proposal § __.10(c)(8)(i)(B). The agencies are adopting this revision, as proposed.

[85] *E.g.*, SIFMA; PNC; and SFA. One commenter indicated that the current Loan Securitization Servicing FAQ was sufficient and that codifying the FAQ was not necessary; however, the commenter did not elaborate on or justify this position. Data Boiler.

The loan securitization exclusion permits issuers relying on the exclusion to hold certain types of contractual rights or assets related to the loans underlying the securitization, including cash equivalents. In response to questions about the scope of the cash equivalents 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.[86] To promote transparency and clarity, the 2020 proposal would have codified this additional language in the Loan Securitization Servicing FAQ regarding the meaning of "cash equivalents."[87] The agencies did not propose requiring "cash equivalents" to be "short term," because the agencies recognized 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. Commenters generally supported the codification of the definition of "cash equivalents" in the loan securitization exclusion.[88] The final rule adopts the codification of "cash equivalents" as proposed.

Limited Holdings of Certain Debt Securities

In the preamble to the 2013 rule, the agencies declined to permit loan securitizations to hold a certain amount of non-loan assets.[89] The agencies supported a narrow scope of

---

[86] *See supra*, n.14.

[87] 2020 proposed rule § __.10(c)(8)(iii)(A).

[88] *E.g.*, LSTA; PNC; and SIFMA. One commenter expressed opposition to this codification but did not elaborate or justify this position. *See* Data Boiler.

[89] 79 FR 5687–88.

permissible assets in loan securitizations, suggesting that such an approach would be consistent with the purpose of section 13 of the BHC Act.[90]

Several commenters on the 2018 proposal disagreed with the agencies' views and supported expanding the range of permissible assets in an excluded loan securitization. After considering the comments received on the 2018 proposal, the 2020 proposal would have allowed a loan securitization vehicle to hold up to five percent of the fund's total assets in non-loan assets. The agencies indicated that 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 investor demand and reduce compliance costs associated with the securitization process without significantly increasing risk to banking entities and the financial system.[91] The agencies requested comment on, among other things, the maximum amount of permitted non-loan assets, the methodology for calculating the cap on non-loan assets, and whether the agencies should limit the type of assets that could be held under the non-loan asset provision. Specifically, the agencies requested comment on whether the non-loan asset provision should be limited to debt securities or should exclude certain financial instruments such as derivatives and collateralized debt obligations.

Commenters were generally supportive of allowing loan securitizations to hold a limited amount of non-loan assets.[92] These commenters indicated that the requirements for the current loan securitization exclusion are too restrictive and excessively limit use of the exclusion and prevent issuers from responding to investor demand, and suggested that a limited bucket of non-

---

[90] 79 FR 5687.

[91] 85 FR 12128–29.

[92] *E.g.*, SIFMA; CCMC; ABA; Credit Suisse; MFA; Goldman Sachs; LSTA; BPI; and SFA.

loan assets would not fundamentally alter the characteristics and risks of securitizations or otherwise increase risks in banking entities or the financial system.[93]

Several commenters recommended against limiting the type of assets that could be held per the non-loan asset provision.[94] For example, one commenter stated that allowing excluded loan securitizations to invest in any class of asset would allow those vehicles to achieve investment goals during periods of constrained loan supply, while another commenter indicated that such a restriction would be unnecessary given that the low limit on non-loan assets would constrain risks.[95] In contrast, one commenter suggested limiting the type of permissible assets to securities with risk characteristics similar to loans.[96]

Numerous commenters suggested raising the cap on non-loan assets from five percent of assets to ten percent of assets,[97] while one commenter indicated that a five percent cap would be sufficient.[98] Commenters that supported an elevated limit on non-loan assets generally argued that a ten percent limit would further reduce compliance burdens while not materially increasing risk.[99]

---

[93] *E.g.*, LSTA and Goldman Sachs.

[94] *E.g.*, MFA; LSTA; and SFA. One commenter also requested that the agencies make clear that the non-loan assets would not be subject to the other provisions of the loan securitization exclusion. LSTA.

[95] SFA and LSTA.

[96] JBA.

[97] SIFMA; CCMC; ABA; Credit Suisse; MFA; Goldman Sachs; LSTA; and SFA.

[98] PNC. Another commenter who generally supported the proposed modifications to the loan securitization exclusion did not urge the agencies to raise the cap on non-loan assets. *See* BPI.

[99] *E.g.*, LSTA; SIFMA; and Goldman Sachs.

Several commenters also suggested a method for calculating the cap on non-loan assets: the par value of assets on the day they are acquired.[100] These commenters suggested that relying on par value is accepted practice in the loan securitization industry and would obviate concerns related to tracking amortization or prepayment of loans in a securitization portfolio.[101] One of these commenters further specified that the limit should be calculated (1) according to the par value of the acquired assets on the date of investment over the securitization's total collateral pool and (2) only at the time of investment.[102] Another commenter indicated that the cap should be calculated as the lower of the purchase price and par value of the non-qualifying assets over the issuer's aggregate capital commitments plus its subscription based credit facility.[103] A third commenter suggested having a separate valuation mechanism for equity securities, which the commenter suggested should be market value upon acquisition.[104]

Finally, two commenters opposed allowing excluded loan securitizations to hold non-loan assets and suggested that such a change would be contrary to the purpose of section 13 of the BHC Act or would result in loan securitizations with differing risk characteristics, potentially increasing monitoring costs on investors.[105] In addition, a commenter claimed that the 2020 proposal to allow excluded loan securitizations to hold non-loan assets would be contrary to section 13 of the BHC Act.[106] Specifically, this commenter suggested that the rule of

---

[100] SIFMA; BPI; ABA; and LSTA.

[101] SIFMA and BPI.

[102] BPI.

[103] Goldman Sachs

[104] SFA.

[105] JBA and Data Boiler.

[106] Occupy.

construction in 12 U.S.C. 1851(g)(2) only permits the securitization or sale of loans and that legislative history supports this reading of the statute.

The agencies previously concluded and continue to believe they have legal authority to adopt the proposed allowance for a limited amount of non-loan assets.[107] Section 13(g)(2) of the BHC Act states, "[n]othing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law."[108] This rule of construction is permissive — it allows the agencies to design the regulations implementing section 13 in a way that accommodates and does not unduly "limit or restrict" the ability of banking entities to sell or securitize loans. Contrary to the commenter's argument, this provision does not mandate that any loan securitization exclusion only relate to loans. As discussed in this section and the preamble to the 2020 proposal,[109] the agencies believe that allowing excluded loan securitizations to hold limited amounts of non-loan assets would, in fact, promote the ability of banking entities to sell or securitize loans.

After considering the foregoing comments, the agencies are revising the loan securitization exclusion to permit a loan securitization to hold a limited amount of debt securities. Loan securitizations provide an important mechanism for banking entities to fund lending programs. Allowing loan securitizations to hold a small amount of debt securities in

---

[107] *See* 79 FR 5688–92 (stating, for example, that "[t]he [a]gencies also do not believe that they lack the statutory authority to permit a loan securitization relying on the loan securitization exclusion to use derivative[s,] as suggested by [Occupy]" and that, more broadly, the agencies have the authority to allow excluded loan securitizations to hold non-loan assets).

[108] 12 U.S.C. 1851(g)(2).

[109] 85 FR 12128–29.

response to customer and market demand may increase a banking entity's capacity to provide financing and lending. To minimize the potential for banking entities to use this exclusion to engage in impermissible activities or take on excessive risk, the final rule permits a loan securitization to hold debt securities (excluding asset-backed securities and convertible securities), as opposed to any non-loan assets, as the 2020 proposal would have allowed.[110]

Although several commenters supported allowing a loan securitization to hold any non-loan asset to provide flexibility and allow the issuer's investment manager to respond to changing market demands, the agencies believe that limiting the assets to debt securities is more consistent with the activities of an issuer focused on securitizing loans, rather than engaging in other activities. The agencies have determined, consistent with the views of another commenter, that non-loan assets with materially different risk characteristics from loans could change the character and complexity of an issuer and raise the type of concerns that section 13 of the BHC Act was intended to address. Moreover, as described further below, limiting the assets to those with risk characteristics that are similar to loans will allow for a simpler and more transparent calculation of the five percent limit, which will facilitate banking entities' compliance with the exclusion. For the same reasons, the final rule does not permit a loan securitization to hold asset-backed securities or convertible securities as part of its five percent allowance for debt securities. This helps to ensure that a loan securitization will not be exposed to complex financial instruments and will retain the general characteristic of a loan securitization issuer.

Similarly, to reduce potential risk-taking and to ensure that the fund is composed almost entirely of loans with minimal non-loan assets, the final rule retains the 2020 proposal's five percent limit on non-loan assets. Commenters differed on whether raising the limit on non-loan

[110] Final rule § __.10(c)(8)(i)(E).

assets was appropriate or necessary to ensure flexibility, and it is not clear what benefit would accrue to issuers who could hold debt securities of, for example, seven or ten percent versus five percent. The amount of non-loan assets held by a fund should not be so significant that it fundamentally changes the character of the fund from one that is engaged in securitizing loans to one that is engaged in investing in other types of assets.

The agencies are also clarifying the methodology for calculating the five percent limit on non-convertible debt securities.[111] The 2020 proposal only provided that "the aggregate value of any such other assets must not exceed five percent of the aggregate value of the issuing entity's assets" and requested comment about how the agencies should calculate this limit.[112] As suggested by several commenters, the final rule specifies that the limit on non-convertible debt securities must be calculated at the most recent time of acquisition of such assets. Specifically, the aggregate value of debt securities held under § __.10(c)(8)(i)(E) of the final rule may not exceed five percent of the aggregate value of loans held under § __.10(c)(8)(i)(A), cash and cash equivalents held under § __.10(c)(8)(iii)(A), and debt securities held under § __.10(c)(8)(i)(E), where the value of the loans, cash and cash equivalents, and debt securities is calculated at par value at the time any such debt security is purchased.[113]

The agencies have chosen the most recent time of acquisition of non-convertible debt securities as the moment of calculation to simplify the manner in which the 5 percent cap applies. This would permit an issuer that, at some point in its life, held debt securities in excess of five percent of its assets to qualify for the exclusion if it came into compliance with the five

---

[111] Final rule § __.10(c)(8)(i)(E)(*1*)-(*2*).

[112] 2020 proposal § __.10(c)(8)(i)(E); 85 FR 12129.

[113] Final rule § __.10(c)(8)(i)(E)(*1*)-(*2*).

percent limit prior to a banking entity relying on the exclusion with respect to such issuer. The agencies believe that a continuous monitoring obligation could impose significant burdens on excluded issuers and could cause an issuer to be disqualified from the loan securitization exclusion based on market events not under its control. It is also unnecessary to require this calculation at other intervals because limiting permissible assets to those that have similar characteristics as loans addresses the potential for evasion of the five percent limit that could arise if the issuer held more volatile assets.[114]

In the final rule, this measurement is based only on the value of the loans and debt securities held under §§ __.10(c)(8)(i)(A) and (E) and the cash and cash equivalents held under § __.10(c)(8)(iii)(A) rather than the aggregate value of all of the issuing entity's assets. The purpose of the five percent limit is to ensure the investment pool of a loan securitization is composed of loans. Therefore, the calculation takes into account the assets that should make up the issuing entity's investment pool and excludes the value of other rights or incidental assets, as well as derivatives held for risk management. This further simplifies the calculation methodology by excluding assets that may be more complex to value and that are ancillary to the loan securitization's investment activities. This straightforward calculation methodology will ensure that the loan securitization exclusion remains easy to use and will facilitate banking entities' compliance with the exclusion.

The agencies recognize that a loan securitization's transaction agreements may require that some categories of loans, cash equivalents, or debt securities be valued at fair market value for certain purposes. To accommodate such situations, the exclusion provides that the value of

[114] The agencies also have authority to address acts that function as an evasion of the requirements of the exclusion. *See* implementing regulations § __.21.

any loan, cash equivalent, or permissible debt security may be based on its fair market value if (1) the issuing entity is required to use the fair market value of such loan or debt security for purposes of calculating compliance with concentration limitations or other similar calculations under its transaction agreements and (2) the issuing entity's valuation methodology values similarly situated assets, for example non-performing loans, consistently. This provision is intended to provide issuers with the flexibility to leverage existing calculation methodologies while preventing issuers from using inconsistent methodologies in a manner to evade the requirements of the exclusion.

Leases

A commenter on the 2018 proposal suggested that the loan securitization exclusion be expanded to cover leases and related assets, including operating or capital leases.[115] In response, in the 2020 proposal the agencies stated that they were "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."[116] That same commenter made a comment on the 2020 proposal urging the agencies to reconsider explicitly including operating leases and leased properties in the loan securitization exclusion.[117] This commenter asserted that unless the agencies specifically revise the definition of "rights or other assets" to explicitly include leased property, then securitization vehicles with operating leases that rely on the residual property value after expiration of the lease to support their asset-backed

[115] *See* 85 FR 12128.

[116] *Id.*

[117] SFA.

securities would not be able to qualify under the loan securitization exemption, despite the 2013 rule's provisions for special units of beneficial interest and collateral certificates.

Consistent with the 2020 proposal, the agencies are not separately listing 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. The agencies are also not modifying the definition of "rights or other assets" to explicitly include leased property, as any residual value of such leased property upon expiration of an operating lease should meet the requirements to constitute an asset that is related or incidental to purchasing or otherwise acquiring and holding loans.

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).[118] Consistent with the statute, the implementing regulations exclude 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), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs) (the public welfare investment exclusion).[119]

---

[118] *See* 12 U.S.C. 1851(d)(1)(E).

[119] Implementing regulations § __.10(c)(11)(ii)(A).

The 2020 proposal noted that 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 Community Reinvestment Act (CRA) are public welfare investments for national banks.[120] The 2020 proposal requested 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.[121] The 2020 proposal specifically asked whether investments that would receive consideration as qualified investments under the CRA should be excluded from the definition of covered fund, either by incorporating these investments into the public welfare investment exclusion or by establishing a new exclusion for CRA-qualifying investments.[122]

In addition, the 2020 proposal requested comment on whether Rural Business Investment Companies (RBICs) are typically excluded from the definition of "covered fund" because of the public welfare investment exclusion or another exclusion and on whether the agencies should expressly exclude RBICs from the definition of covered fund.[123] RBICs are licensed under a program 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.[124]

---

[120] *See* 85 FR 12130; 12 CFR 24.3.

[121] *See* 85 FR 12130 (noting that such a change could provide additional certainty regarding community development investments made through fund structures).

[122] *See id.*

[123] *See id.*

[124] *See id.*

The Tax Cuts and Jobs Act established the "opportunity zone" program to provide tax incentives for long-term investing in designated economically distressed communities.[125] The program allows taxpayers to defer and reduce taxes on capital gains by reinvesting gains in "qualified opportunity funds" (QOF) that are required to have at least 90 percent of their assets in designated low-income zones.[126] The 2020 proposal requested comment on whether many or all QOFs would meet the terms of the public welfare investment exclusion and on whether the agencies should expressly exclude QOFs from the definition of covered fund.[127]

Commenters generally supported clarifying that funds that make investments that qualify for consideration under the CRA qualify for the public welfare investment exclusion.[128] Commenters noted that this clarification would be consistent with the OCC's regulations concerning public welfare investments and the CRA, provide greater certainty, and avoid unnecessarily chilling public welfare investment activities.[129] One commenter stated that some banking entities have been reluctant to invest in certain community development funds due to uncertainty as to whether these funds were covered funds.[130] This commenter stated that explicitly excluding funds that qualify for consideration under the CRA from the definition of covered fund would eliminate this uncertainty and would help support the type of community

---

[125] *See id.*

[126] *See id.*

[127] *See id.*

[128] *See* SIFMA; FSF; BPI; ABA; PNC; Community Development Venture Capital Alliance (CDVCA); IIB; and Data Boiler (stating that incorporating the CRA public welfare exemption may ease some challenges faced by communities during the current COVID pandemic, but all PWI should not be excluded).

[129] *See* SIFMA; FSF; and CDVCA.

[130] *See* CDVCA.

development efforts that the public welfare investment exclusion was designed to promote.[131] In addition, some commenters recommended excluding funds that qualify for the public welfare investment exclusion from the definition of "banking entity."[132]

Commenters also generally favored explicitly excluding RBICs and QOFs from the definition of "covered fund," either by adopting new exclusions, or by clarifying the scope of the public welfare investment exclusion.[133] Commenters stated that explicitly excluding these funds from the definition of "covered fund" would be consistent with the statutory provision permitting public welfare investments. Commenters stated that RBICs and QOFs must make investments that are clearly designed primarily to promote the public welfare because they are required to invest primarily in ways that promote job creation in rural communities (which may have significant low- and moderate-income populations or be economically disadvantaged and in need of revitalization or stabilization) and in economically distressed communities, respectively.[134] Commenters stated that certain RBICs and QOFs qualify for the public welfare investment exclusion, but providing an express exclusion for these funds would reduce uncertainty and associated compliance burdens and would encourage banking entities to provide capital to projects that promote economic development in rural and low-income communities.[135] One commenter stated that RBICs and QOFs engage in investments that are substantively similar or identical to those of public welfare investment funds that are already excluded from the

---

[131] *See id.*

[132] *See* SIFMA; BPI; ABA; and IIB.

[133] *See* SIFMA; FSF; ABA (addressing QOFs); and Small Business Investor Alliance (SBIA) (addressing RBICs).

[134] *See* SIFMA and FSF.

[135] *See* SIFMA and FSF.

definition of covered fund and of the type that Congress recognized that section 13 of the BHC Act was not designed to prohibit.[136] Another commenter stated that explicitly excluding RBICs would result in the provision of valuable expertise and services to RBICs and provide funding and assistance to small businesses and low- and moderate-income communities.[137] One commenter expressed skepticism about providing a new exclusion for RBICs and QOFs but suggested that certain of these funds may currently qualify for the public welfare investment exclusion.[138] Another commenter stated that it is not necessary to expressly exclude QOFs from the definition of covered fund, noting that these funds should be of the type primarily intended to promote the public welfare of low- and moderate-income areas and should therefore qualify for the current public welfare investment exclusion.[139]

After carefully considering the comments received, the agencies are revising the public welfare investment exclusion to explicitly incorporate funds, the business of which is to make investments that qualify for consideration under the Federal banking agencies' regulations implementing the CRA.[140] Explicitly excluding these types of investments from the definition of covered fund clarifies and gives full effect to the statutory exemption for public welfare investments.[141] In addition, this clarification will reduce uncertainty and will facilitate public welfare investments by banking entities.

---

[136] *See* SIFMA.

[137] *See* SBIA.

[138] *See* Data Boiler.

[139] *See* PNC.

[140] Final rule § __.10(c)(11)(ii)(A).

[141] *See* 12 U.S.C. 1851(d)(1)(E). 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.

The agencies are also adopting explicit exclusions from the definition of covered fund for RBICs and QOFs in § __.10(c)(11) of the final rule. These types of funds were created by Congress to promote development in rural and low-income communities, and, due to their similarity to SBICs and public welfare investments, the agencies believe that section 13 of the BHC Act was not intended to restrict the types of funds that engage in those activities. RBICs are companies licensed under the Rural Business Investment Program, a program designed to promote economic development and the creation of wealth and job opportunities among individuals living in rural areas and to help meet the equity capital investment needs primarily of smaller enterprises located in such areas.[142] Likewise, QOFs were developed as part of a program to promote long-term investing in designated economically distressed communities and are required to have at least 90 percent of their assets in designated low-income zones.[143] Congress created RBICs and QOFs to encourage investment in rural areas, small enterprises, and low-income areas. Providing an explicit exclusion for these funds in the implementing regulations gives effect to section 13 of the BHC Act's provision permitting public welfare investments and avoids chilling the activities of funds that were not the target of section 13 of the BHC Act.[144] Although many of these funds may already qualify for the public welfare investment exclusion, the agencies are explicitly excluding these funds from the definition of covered fund to reduce uncertainty and compliance burden. Thus, under the final rule, a covered

---

[142] *See, e.g.*, Rural Business Investment Company (RBIC) Program, 85 FR 16519, 16520 (Mar. 24, 2020).

[143] *See* 26 U.S.C. 1400Z-2(d).

[144] *See* 12 U.S.C. 1851(d)(1)(E); 156 Cong. Rec. S5896 (daily ed. July 15, 2010) (Statement of Sen. Merkley) (noting that Section 13(d)(1)(E) permits investments "of the type" permitted under 12 U.S.C. § 24 (Eleventh), including "a range of low-income community development and other projects," but "is flexible enough to permit the [agencies] to include other similar low-risk investments with a public welfare purpose").

fund does not include an issuer that has elected to be regulated or is regulated as a RBIC, as described in 15 U.S.C. 80b-3(b)(8)(A) or (B), or that has terminated its participation as a RBIC in accordance with 7 CFR 4290.1900 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 termination.[145] Likewise, under the final rule, a covered fund does not include an issuer that is a QOF, as defined in 26 U.S.C. 1400Z-2(d).[146]

The final rule does not exclude funds that qualify for the public welfare investment exclusion from the definition of "banking entity" as requested by some commenters.[147] The term "banking entity" is specifically defined in section 13 of the BHC Act.[148] In addition, the agencies do not believe that applying the definition of banking entity places an undue burden on banking entities' public welfare investments. The agencies believe that banking entities are able to design their permissible public welfare investments so as not to cause the investment fund to become a banking entity. For public welfare investment funds that are banking entities, the agencies believe that the burden-reducing amendments adopted in this final rule and the 2019 amendments should mitigate concerns about compliance burdens.

---

[145] Final rule § __.10(c)(11)(iii). As with SBICs, discussed below, the final rule contemplates that an issuer that ceases to be a RBIC during wind-down may continue to qualify for the exclusion from the definition of "covered fund" for RBICs if the issuer satisfies certain conditions designed to prevent abuse.

[146] Final rule § __.10(c)(11)(iv). As with other types of issuers excluded from the covered fund definition, a banking entity must have independent authority to invest in a QOF.

[147] *See* SIFMA and BPI.

[148] 12 U.S.C. 1851(h)(1).

ii. Small Business Investment Companies

Consistent with section 13 of the BHC Act,[149] the implementing regulations exclude from the definition of "covered fund" SBICs and issuers that have received notice from the Small Business Administration to proceed to qualify for a license as an SBIC, which notice or license has not been revoked.[150] The agencies proposed revising the exclusion for SBICs to clarify how the exclusion would apply to SBICs that surrender their licenses during wind-down phases.[151] Specifically, the agencies proposed revising the exclusion for SBICs to apply explicitly to an issuer that has voluntarily surrendered its license to operate as an SBIC in accordance with 13 CFR 107.1900 and does not make new investments (other than investments in cash equivalents) after such voluntary surrender.[152] The agencies explained that applying the exclusion to an issuer that has surrendered its SBIC license is appropriate because of the statutory exemption for investments in SBICs and because banking entities may otherwise become discouraged from investing in SBICs due to concerns that an SBIC may become a covered fund during its wind-down phase.[153] The agencies further noted that the proposed revisions included a number of requirements designed to ensure that the exclusion would not be abused.[154] In particular, the exclusion would apply only to an issuer that voluntarily surrenders its license in accordance with

---

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

[150] *See* implementing regulations § __.10(c)(11)(i).

[151] *See* 85 FR 12131.

[152] *See id.*

[153] *See id.*; 12 U.S.C 1851(d)(1)(E).

[154] *See* 85 FR 12131.

13 CFR 107.1900 and that does not make any new investments (other than investments in cash equivalents).[155]

Most commenters that directly addressed the 2020 proposal's revisions concerning SBICs supported the proposed revisions, stating that the proposed revisions would provide greater certainty to banking entities wishing to invest in SBICs and would increase investment in small businesses.[156] One commenter stated that revising the exclusion for SBICs would prevent a banking entity from being forced to sell an interest in an SBIC that became a covered fund for reasons outside of the banking entity's control.[157] Commenters further noted that the proposed revisions included sufficient safeguards against evasion and did not present safety or soundness concerns.[158] One commenter recommended against revising the exclusion from the definition of covered fund for SBICs. This commenter expressed concern about frequent buying and selling of SBICs and noted that section 13 of the BHC Act and its implementing regulations do not prohibit a banking entity from lending to small businesses.[159] The commenter further expressed concern that an SBIC that surrenders its license may be doing so because it has failed or no longer wishes to comply with the Small Business Administration's regulations.[160]

---

[155] *See id.*

[156] *See* SIFMA; BPI; ABA; PNC; and SBIA.

[157] *See* SBIA.

[158] *See* SIFMA; BPI; and SBIA.

[159] *See* SIFMA; BPI; and SBIA.

[160] *See* Data Boiler.

After carefully considering the comments received, the agencies are adopting the revisions to the exclusion from the definition of covered fund for SBICs, as proposed.[161] The revisions will provide greater certainty to banking entities, give full effect to the provision of section 13 of the BHC Act that permits investments in SBICs, and support capital formation for small businesses. In response to one commenter's concerns regarding the exclusion for SBICs,[162] the agencies note that a banking entity's investment in an SBIC must comply with all applicable laws and regulations, including the prohibition against proprietary trading under section 13 of the BHC Act and its implementing regulations. Furthermore, as noted above, the revised exclusion for SBICs includes safeguards designed to prevent abuse or evasion. In particular, the exclusion would only apply to an issuer that has voluntarily surrendered its license to operate as an SBIC in accordance with 13 CFR 107.1900 and that does not make new investments (other than investments in cash equivalents) after such voluntary surrender.

C. Additional Covered Fund Exclusions

In addition to modifying certain existing exclusions, the agencies are creating four new exclusions from the definition of "covered fund" to better tailor the provision to the types of entities that section 13 was intended to cover. These exclusions are for credit funds, venture capital funds, family wealth management vehicles, and customer facilitation vehicles.

General Comments

Many commenters were broadly supportive of the proposed new exclusions from the definition of "covered fund."[163] Some commenters recommended adopting additional exclusions

---

[161] *See* final rule § __10(c)(11)(i).

[162] *See* Data Boiler.

[163] *E.g.*, SIFMA; JBA; Credit Suisse; and SAF.

for an array of fund types and situations, including for tender bond vehicles,[164] ownership interests erroneously acquired or retained,[165] certain real estate funds,[166] and funds in their seeding period.[167] The agencies are declining to adopt these suggested exclusions because the requested actions are outside the scope of the current rulemaking. In addition, one commenter urged the agencies to redefine the definition of "covered fund," to rely on a characteristics-based approach.[168] The agencies decline to revise the definition of "covered fund" for the reasons articulated in the preamble to the 2013 rule.[169]

1. Credit Funds

i. Background and 2020 Proposal

In the preamble to the 2013 rule, the agencies declined to establish an exclusion from the definition of covered fund for funds that make loans, invest in debt, or otherwise extend the type of credit that banking entities may provide directly under applicable banking law (credit funds).[170] The agencies cited concerns about whether credit 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

---

[164] SIFMA.

[165] SIFMA and BPI.

[166] IAA.

[167] ABA.

[168] JBA.

[169] *See* 79 FR 5671.

[170] *See* 79 FR 5705.

definition of covered fund in the 2013 rule, such as the exclusion for joint ventures or the exclusion for loan securitizations.[171]

However, commenters on the 2018 proposal noted that many credit funds have not been able to utilize the joint venture and loan securitization exclusions. In response, the agencies included in the 2020 proposal a specific exclusion for credit funds. Under the 2020 proposal, a credit fund would have been 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.[172]

The proposed exclusion would have been subject to certain additional requirements to reduce evasion concerns and help ensure that banking entities invest in, sponsor, or advise credit funds in a safe and sound manner. For example, the proposed exclusion would have imposed (1) certain activity requirements on the credit fund, including a prohibition on proprietary trading;[173] (2) disclosure and safety and soundness requirements on banking entities that sponsor or serve as an advisor for a credit fund;[174] (3) safety and soundness requirements on all banking entities that invest in or have certain relationships with a credit fund;[175] and (4) restrictions on the banking

---

[171] *Id.*

[172] 2020 proposal § __.10(c)(15)(i).

[173] 2020 proposal § __.10(c)(15)(ii).

[174] 2020 proposal § __.10(c)(15)(iii).

[175] 2020 proposal § __.10(c)(15)(iv).

entity's investment in, and relationship with, a credit fund.[176] The proposed exclusion also would have permitted a credit fund to receive and hold a limited amount of equity securities (or rights to acquire equity securities) that were received on customary terms in connection with the credit fund's loans or debt instruments.[177]

ii. Comments

The agencies requested comment on all aspects of the proposed credit fund exclusion. In addition, the agencies solicited comment on specific provisions of the proposed exclusion, including the permissibility of certain assets and requirements related to the activities of the credit fund and the relationship between a banking entity and a credit fund.[178]

General

Commenters were generally supportive of adopting an exclusion for credit funds, and several commenters suggested specific revisions to the proposed exclusion.[179] Several commenters supportive of the 2020 proposal urged the agencies not to adopt any further limitations on the proposed exclusion and indicated that the proposed exclusion would not increase the risk of evasion of the requirements of section 13 of the BHC Act.[180] Two commenters expressed general opposition to or concern about the proposed credit fund exclusion.[181]

---

[176] 2020 proposal § __.10(c)(15)(v).

[177] 2020 proposal § __.10(c)(15)(i)(C)(*1*)(*iii*).

[178] *See* 85 FR 12133.

[179] *E.g.*, CCMC; AIC; SIFMA; FSF; ABA; Arnold & Porter; and Goldman Sachs.

[180] *E.g.*, SIFMA; Credit Suisse; Goldman Sachs; and Arnold & Porter.

[181] Better Markets and Data Boiler. One of these commenters suggested that banking entities should instead rely on the exclusions for joint ventures and loan securitizations. Data Boiler.

Asset Requirements

Commenters were generally supportive of allowing a credit fund to invest broadly in loans and debt instruments, certain related assets, and certain derivatives.[182] One commenter recommended against delineating between permissible and non-permissible types of loans and debt instruments, arguing that credit funds should be able to extend credit to the same degree as would be permitted for the banking entity to extend directly.[183] Another commenter encouraged the agencies to clarify and expand the definition of debt instrument and derivatives, to include all tranches of debt, collateralized loan and collateralized debt obligations, and any derivatives related to hedging credit risk, such as credit default swaps and total return swaps.[184] In addition, a commenter suggested clarifying that no specific credit standard applies to loans held by a credit fund.[185] One commenter also urged the agencies to establish a safe harbor to the permissible asset restrictions for banking entities that rely, in good faith, on a representation by the credit fund that the credit fund only invests in permissible assets.[186]

---

[182] *E.g.*, SIFMA; Arnold & Porter; and ABA. One commenter also noted that the permissible holding period for debt previously contracted varies depending on applicable regulations and suggested that the agencies specify the holding period for debt previously contracted assets owned by a credit fund and provide for an extension process. Arnold & Porter.

[183] SIFMA. The same commenter also urged the agencies to permit credit funds to hold commodity forward contracts, which the commenter argued may be an appropriate hedge for extensions of credit to agricultural businesses. SIFMA.

[184] Credit Suisse. *See also* Arnold & Porter (recommending expanding the types of permissible derivatives, to allow for more effective hedging and easier disposal of portfolio assets).

[185] ABA.

[186] Arnold & Porter.

Two commenters recommended limiting permissible assets to only loans or debt instruments, and not equity.[187] In contrast, a range of commenters argued that allowing a credit fund to receive certain assets, like equity, related to an extension of credit would promote the sale of loans and extensions of credit.[188] Some of these commenters suggested that taking equity as partial consideration for extending credit is commonplace in the debt and loan markets and that such a provision could ensure that credit funds are able to facilitate loan and debt workouts and restructurings, a critical financial intermediation function.[189] Most commenters supportive of the 2020 proposal were generally opposed to a quantitative limit on the amount of equity securities (or rights to acquire an equity security) received on customary terms in connection with such loans or debt instruments that could be held by a credit fund, citing compliance costs and diminished flexibility,[190] but some commenters indicated that a limitation of 20 or 25 percent of total assets could be acceptable if the agencies were to impose a limit.[191]

Commenters supportive of allowing credit funds to hold certain related assets, such as equity, in connection with an extension of credit suggested that the provision would not raise

---

[187] Data Boiler and Better Markets. One of these commenters argued that the inclusion of non-loan instruments would be contrary to the purpose of section 13 of the BHC Act. Data Boiler. As indicated by the agencies in the preamble to the 2020 proposal, taking limited amounts of non-loan or debt assets as consideration for an extension of credit is common and is a permitted practice for insured depository institutions. Therefore, the agencies believe it would not be inconsistent with section 13 of the BHC Act to facilitate the sale of loans by establishing a credit fund exclusion that allows a credit fund to hold a limited amount of certain equity instruments related to extensions of credit. See also the discussion about permitting excluded loan securitizations to hold a small amount of non-loan assets, *supra* Section IV.B.2 (Loan Securitizations).

[188] *E.g.*, SIFMA; Credit Suisse; ABA; and Arnold & Porter

[189] *E.g.*, SIFMA; Credit Suisse; and Arnold & Porter.

[190] SIFMA; FSF; CCMC; AIC; ABA; and Goldman Sachs

[191] SIFMA and CCMC.

significant safety and soundness or evasion concerns. For example, one commenter claimed that such a provision would not raise the risk of evasion, in part, because equity options received as consideration generally expire unexercised.[192] Other commenters argued that the activity requirements of the exclusion would prevent a credit fund from becoming actively involved in the purchase and sale of equity instruments.[193] Another commenter suggested that the agencies could impose a requirement that non-loan or non-debt assets be acquired on arms-length terms and adhere to bank safety and soundness standards.[194]

Separately, several commenters recommended allowing excluded credit funds to hold any type of asset, up to a certain percentage of aggregate assets, either 20 or 25 percent of a credit fund's total assets.[195] These commenters asserted that permitting a credit fund to own equity securities and other assets would help the fund more effectively provide credit, without altering the character of the credit fund, and would reduce compliance burdens associated with launching and operating a credit fund.[196] In addition, these commenters claimed that a limited bucket for non-loan and non-debt assets would be consistent with the ability of banking entities and some business development companies to invest in equity.[197]

Banking Entity and Issuer Requirements

---

[192] Arnold & Porter.

[193] Goldman Sachs and FSF.

[194] ABA.

[195] SIFMA; FSF; Credit Suisse; ABA; and Goldman Sachs. One commenter also suggested a formula for determining the cap. Goldman Sachs.

[196] *E.g.*, SIFMA and Goldman Sachs.

[197] *Id.*

Generally, commenters either agreed that certain restrictions to ensure that a credit fund is actually engaged in prudently providing credit and credit intermediation and is not operated for the purpose of evading the provisions of section 13 of the BHC Act were appropriate or did not object to the inclusion of these requirements.[198] Several commenters, however, offered revisions to the activities, sponsor or advisor, banking entity, or investment and relationship limit requirements. For example, several commenters requested clarification on the prohibition on proprietary trading by an excluded credit fund contained in § __.10(c)(15)(ii)(A) of the 2020 proposal. One commenter suggested that the definition of proprietary trading for a credit fund should depend on the definition used by the banking entity.[199] Another commenter encouraged the agencies to incorporate the exclusions and exemptions from the prohibition on proprietary trading into the credit fund exclusion's prohibition on proprietary trading.[200] A third commenter recommended making explicit that exercising rights for certain related assets, such as an equity warrant, is not proprietary trading.[201]

Commenters also requested revisions to and clarification about the limits on a banking entity's investment in, and relationship with, a credit fund. One commenter argued that the imposition of § __.14 of the implementing regulations (which imposes limitations on the relationship between a banking entity and a fund it sponsors or advises) would be duplicative of

---

[198] *E.g.*, SIFMA; Better Markets; FSF; and Goldman Sachs. One commenter also indicated that the disclosure requirement for banking entities that sponsor or advise funds is appropriate. Arnold & Porter.

[199] SIFMA. For example, the commenter suggested that a credit fund sponsored by a banking entity subject to the market risk rule should be permitted to use the definitions of proprietary trading and trading account in § __.3(b)(1)(ii).

[200] FSF.

[201] Arnold & Porter.

(1) the requirement that the banking entity not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the credit fund and (2) certain conflict of interest, high-risk, and safety and soundness restrictions.[202] Another commenter claimed that there was little benefit to imposing the requirements of § __.14 (described above) and § __.15 (which imposes certain material conflicts of interest, high-risk investments, and safety and soundness and financial stability requirements on permitted covered fund activities) of the implementing regulations in the context of credit funds and suggested that the partial application of § __.14, in particular, could lead to unexpected and inappropriate outcomes, such as allowing a banking entity to invest in the equity of a credit fund, but not the debt instruments issued by that same credit fund.[203] That same commenter also recommended eliminating § __.10(c)(15)(v)(B) of the 2020 proposal – which would have required that the banking entity's investment in, and relationship with, the credit fund be conducted in compliance with, and subject to, applicable banking laws and regulations – because applicable banking laws and regulations apply regardless of the banking entity's use of the credit fund exclusion.[204]

In addition, a commenter argued that banking entities that serve as investment advisers or commodity trading advisors to credit funds should not be subject to the disclosure and safety and soundness requirements of § __.10(c)(15)(iii) of the 2020 proposal since investment advisers and commodity trading advisors who do not otherwise sponsor or invest in a fund are generally not subject to section 13 of the BHC Act. The commenter argued that § __.10(c)(15)(iii) of the 2020 proposal would impose differing requirements on a credit fund depending on whether the

---

[202] SIFMA.

[203] Arnold & Porter.

[204] Arnold & Porter.

investment adviser or commodity trading advisor was an insured depository institution or a bank holding company. That commenter also claimed that the portfolio requirements in § __.10(c)(15)(iv)(B) of the 2020 proposal could require banking entities to establish complex compliance programs to assess credit fund compliance with state and foreign laws and that the agencies should limit the scope of the provision to only federal banking laws and regulations.[205]

Finally, one commenter contended that the application of certain requirements in the exclusion is contingent on the type of banking entity that invests in or sponsors a credit fund and urged the agencies to make explicit that only the identity of the sponsor of the credit fund, and not its affiliates or third-party investors, determines which portfolio quality and safety and soundness requirements apply to the credit fund.[206] More generally, this commenter asked the agencies to make explicit in the preamble to the final rule that the actions of unaffiliated, third-party banking entities do not affect whether a banking entity may invest in a fund.[207]

Other Comments

Commenters also submitted several miscellaneous comments about the proposed exclusion for credit funds. One commenter requested that the agencies clarify the definition of asset-backed securities as used in the proposed credit fund exclusion and the current loan securitization exclusion.[208] That same commenter also urged the agencies to revise the proposed credit fund exclusion to allow banking entities with more stringent credit requirements, such as insured depository institutions, to invest in credit funds that hold distressed debt.[209]

---

[205] *Id.*

[206] *Id.*

[207] *Id.*

[208] *Id.*

[209] *Id.*

Finally, the 2020 proposal requested comment on whether to combine the proposed credit fund exclusion with the loan securitization exclusion. Commenters were generally opposed to combining the two exclusions, citing different classes of assets in which the two types of issuers invest and a fundamental difference in structure (loan securitizations issue asset-backed securities, while credit funds do not).[210] In addition, one commenter argued that while combining the two exclusions would increase the simplicity of the rule, such an amalgamated exclusion could result in increased compliance burdens for issuers who are accustomed to the lack of credit requirements in the current loan securitization exclusion.[211]

iii. Final Exclusion

After consideration of the comments, the agencies are adopting the credit fund exclusion as proposed, with certain modifications. The agencies believe that the credit fund exclusion in the final rule (1) addresses the application of the covered fund provisions to credit-related activities that certain banking entities are permitted to engage in directly and (2) is consistent with Congress's intent that section 13 of the BHC Act limit banking entities' investment in and relationships with hedge funds and private equity funds, but not limit or restrict banking entities' ability to extend credit.[212] The agencies also believe that the credit fund exclusion in the final rule, with the eligibility criteria described below, will address concerns the agencies expressed in the preamble to the 2013 rule about the ability to administer an exclusion for credit funds and the potential evasion of section 13 of the BHC Act.[213] Banking entities already have experience

---

[210] SIFMA; FSF; CCMC; Credit Suisse; and Data Boiler.

[211] Arnold & Porter.

[212] *See* 12 U.S.C. 1851(g)(2), (h)(2). Paragraph (g)(2) of section 13 of the BHC Act makes clear that the Volcker rule is not intended to impede banking entities' ability to extend credit by, for example, selling loans or securitize loans. *See* 12 U.S.C. 1851(g)(2).

[213] *See* 79 FR 5705.

using and complying with the loan securitization exclusion. Establishing an exclusion for credit funds based on the framework provided by the loan securitization exclusion allows 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 credit fund exclusion limits the universe of potential funds that can rely on the exclusion by clearly specifying the types of activities in which those funds may engage. Excluded credit funds can transact in or hold only loans; debt instruments that would be permissible for the banking entity relying on the exclusion to hold directly; certain rights or assets that are related or incidental to the loans or debt instruments, including equity securities (or rights to acquire an equity security) received on customary terms in connection with such loans or debt instruments; and certain interest rate and foreign exchange derivatives. The credit fund exclusion, with these eligibility criteria, should not raise evasion concerns. Similarly, the agencies' expectations regarding the amount of permissible equity securities (or rights to acquire an equity security) held and the requirement that the credit fund not engage in activities that would constitute proprietary trading should help to ensure that the extensions of credit, whether directly originated or acquired from a third party, are held by the credit fund for the purpose of facilitating lending 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 criteria for the credit fund exclusion will prevent a banking entity from 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.

Consistent with commenters' suggestions, the agencies are keeping separate the credit fund exclusion and the loan securitization exclusion because the structures and purposes of those two types of issuers differ sufficiently to warrant different requirements. For example, loan securitizations and credit funds have different asset composition and different financing and legal structures. Therefore, the agencies are finalizing a credit fund exclusion separate from the loan securitization exclusion.

Asset Requirements

Under the final rule, a credit fund, for the purposes of the credit fund 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.[214]

Several provisions of the exclusion are similar to and modeled on conditions in the loan securitization exclusion to ease compliance burdens. For example, 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.[215] In addition, any related rights or other assets held that are securities must be cash equivalents, securities

[214] Final rule § __.10(c)(15)(i).

[215] Final rule § __.10(c)(15)(i)(D).

received in lieu of debts previously contracted with respect to loans held or, unique to the credit fund exclusion, equity securities (or rights to acquire equity securities) received on customary terms in connection with the credit fund's loans or debt instruments.[216]

In the 2020 proposal, the agencies requested comment on whether to impose a limit on the amount of equity securities (or rights to acquire equity securities) that may be held by an excluded credit fund.[217] After a review of the comments and further deliberation, the agencies are not adopting a quantitative limit on the amount of equity securities (or rights to acquire equity securities) that may be held by an excluded credit fund. Any such equity securities or rights are limited by the requirements that they be (a) received on customary terms in connection with the fund's loans or debt instruments and (b) related or incidental to acquiring, holding, servicing, or selling those loans or debt instruments. The agencies generally expect that the equity securities or rights satisfying those criteria in connection with an investment in loans or debt instruments of a borrower (or affiliated borrowers) would not exceed five percent of the value of the fund's total investment in the borrower (or affiliated borrowers) at the time the investment is made. The agencies understand that the value of those equity securities or other rights may change over time for a variety of reasons, including as a result of market conditions and business performance, as well as more fundamental changes in the business and the credit fund's corresponding management of the investment (e.g., exchanges of debt instruments for equity in connection with mergers and restructurings or a disposition of all portion of the credit investment without a corresponding disposition of the equity securities or rights due to

[216] Final rule § __.10(c)(15)(i)(C). In a minor change from the 2020 proposal, the agencies are making clear that rights or other assets held under paragraph (c)(15)(i)(C) of that section may not include any derivative, other than a derivative that meets the requirements of paragraph (c)(15)(i)(D) of that section.

[217] 85 FR 12133.

differences in market conditions or other factors). Accordingly, the agencies can foresee various circumstances where the relative value of such equity securities or rights in a borrower (or affiliated borrowers) would over the life of the investment exceed five percent on a basis consistent with the requirements. Nonetheless, the agencies expect that the fund's exposure to equity securities (or other rights), individually and collectively and when viewed over time, would be managed on a basis consistent with the fund's overall purpose.

The agencies are also not imposing additional restrictions on the types of equity securities (or rights to acquire an equity security) that a credit fund may hold. The final rule prevents a banking entity from relying on the credit fund exclusion unless any debt instruments and equity securities (or rights to acquire an equity security) held by the credit fund and received on customary terms in connection with the credit fund's loans or debt instruments are permissible for the banking entity to acquire and hold directly and a sponsor of a credit fund must ensure that the credit fund complies with certain safety and soundness standards.[218] Combined with the prohibition on proprietary trading by a credit fund,[219] these limitations are expected to prevent evasion of section 13 of the BHC Act and should be sufficient to prevent banking entities from investing in or sponsoring credit funds that hold excessively risky equity securities (or rights to acquire an equity security).[220]

---

[218] Final rule § __.10(c)(15)(iv)(B), (iii)(B).

[219] Final rule § __.10(c)(15)(ii)(A).

[220] One commenter suggested requiring that equity securities (or rights to acquire an equity security) be acquired via arms-length market transactions and adhere to bank safety and soundness standards. *See* ABA. Under the final rule, a banking entity may not rely on the credit fund exclusion unless any equity securities (or rights to acquire an equity security) held by the credit fund are permissible for the banking entity to acquire and hold directly under applicable federal banking laws and regulations. Final rule § __.10(c)(15)(iv)(B). In addition, the final rule requires that equity securities (or rights to acquire an equity security) related or incidental to acquiring, holding, servicing, or selling such loans or debt instruments must be received on

The agencies are, however, clarifying that the provision allowing related rights and other assets does not separately permit the holding of derivatives. The preamble to the 2020 proposal made clear that "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."[221] The agencies suggested then and currently believe that allowing a credit fund issuer to hold derivatives not related to interest rate or foreign exchange hedging would not be necessary to facilitate the indirect extension of credit by banking entities and may pose the very risks that section 13 of the BHC Act was intended to reach. To ensure that the credit fund exclusions does not inadvertently allow the holding of certain derivatives unrelated to interest rate and/or foreign exchange risks, the final rule explicitly excludes derivatives from permissible related right and other assets.[222]

The agencies are not adopting a broad expansion of permissible assets, as recommended by several commenters. Contrary to commenters' suggestions, allowing credit funds to hold unlimited amounts of non-debt instruments or derivatives, such as credit default or total return swaps, could present evasion concerns and is not necessary for effectuating the rule of construction.[223] The agencies believe that only those instruments that facilitate the extension of

---

customary terms in connection with such loans or debt instruments. Final rule § __.10(c)(15)(i)(C)(*1*)(*iii*). Finally, a banking entity's investment in, and relationship with, the issuer must comply with the limitations imposed in § __.15, as if the issuer were a covered fund. Final rule § __.10(c)(15)(v)(A).

[221] 85 FR 12132.

[222] Final rule § __.10(c)(15)(i)(C)(*2*).

[223] The agencies' rationale, in the preamble to the 2013 rule, for limiting the permissible assets for the loan securitization exclusion is particularly relevant. *See* 79 FR 5691 ("Under the final rule as adopted, an excluded loan securitization would not be able to hold derivatives that would relate to risks to counterparties or issuers of the underlying assets referenced by these derivatives because the operation of derivatives, such as these, that expand potential exposures beyond the

credit and directly-related hedging activities should be permitted under the exclusion. For example, allowing the unlimited holding of credit default swaps by a majority owned or sponsored credit fund could raise the risks that section 13 of the BHC Act was intended to address. Moreover, permitting excluded credit funds to invest up to 25 percent of total assets in any type of asset could turn the exclusion for credit funds into an exclusion for the type of funds that section 13 of the BHC Act was intended to address. Such a result would be contrary to section 13 of the BHC Act.

There are several additional changes recommended by commenters that the agencies are not including in the final rule. Specifically, the final rule does not:

- Allow excluded credit funds to hold commodity forward contracts. Although these contracts have legitimate value as hedging instruments, the agencies do not believe this type of hedging activity is consistent with the purpose of the exclusion for credit funds, which is to allow banking entities to share the risks of their permissible lending activities or to engage in permissible lending activities indirectly through a fund structure.
- Permit banking entities that are insured depository institutions or their operating subsidiaries to invest in credit funds through a contribution to a credit fund of

---

loans and other assets, would not in the Agencies' view be consistent with the limited exclusion contained in the rule of construction under section 13(g)(2) of the BHC Act, and could be used to circumvent the restrictions on proprietary trading and prohibitions in section 13(f) of the BHC Act. The Agencies believe that the use of derivatives by an issuing entity for asset-backed securities that is excluded from the definition of covered fund under the loan securitization exclusion should be narrowly tailored to hedging activities that reduce the interest rate and/or foreign exchange risks directly related to the asset-backed securities or the loans supporting the asset-backed securities because the use of derivatives for purposes other than reducing interest rate risk and foreign exchange risks would introduce credit risk without necessarily relating to or involving a reduction of interest rate risk or foreign exchange risk.").

troubled loans and debt previously contracted assets from the banking entity's portfolio. The conditions in the final rule are intended to ensure that a credit fund generally engages in activities that the banking entity may engage in directly and that the banking entity's investment in and relationship with the fund are conducted in a safe and sound manner. The agencies decline to deviate from these standards for any particular type of credit fund because doing so could permit activities that raise the type of concerns that section 13 of the BHC Act was intended to address.

- Further specify the holding period for securities held in lieu of debts previously contracted held by a credit fund. Generally, a banking entity may not rely on this exclusion unless any debt instruments and equity securities (or rights to acquire equity securities) held by the fund would be permissible for the banking entity to acquire and hold directly under applicable federal banking laws and regulations. However, the requirement that a banking entity be able to hold a given asset directly does not apply to securities held in lieu of debts previously contracted under the final regulations. Because a banking entity's ability to invest in or sponsor an excluded credit fund is not contingent on how long the credit fund holds securities held in lieu of debts previously contracted, the agencies do not believe it is necessary to amend the regulations to impose a specific holding period on securities held by a credit fund in lieu of debts previously contracted.[224]
- Revise or expand on the definition of debt instrument. The agencies believe that the term debt instrument already has a general meaning that is used in the marketplace

[224] The agencies note that banking entities must otherwise comply with applicable law. *See infra, Additional Banking Entity Requirements*.

and by regulators and that a new definition is unnecessary given this widely understood meaning and could cause confusion.

- Adopt a safe harbor for banking entities that rely, in good faith, on a representation by the credit fund that it only invests in permissible assets. It is the responsibility of the banking entity to ensure that it complies with section 13 of the BHC Act and the implementing regulations, and such responsibility cannot be substituted solely with a representation from a credit fund.

Activity requirements

The agencies are adopting the activity requirements for issuers in the 2020 proposal without revision. Under the final rule, a credit fund is not 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;[225] and
- The fund does not issue asset-backed securities.[226]

The agencies decline to adopt changes recommended by commenters because the agencies believe the activity requirements are clear and appropriate. The first provision explicitly references the prohibition on proprietary trading by a banking entity in § __.3 of the implementing regulations and, in particular, the short-term intent prong contained in § __.3(b)(1)(i). For the avoidance of doubt, a credit fund would not be able to elect a different definition of proprietary trading or trading account. Varying the definition of proprietary trading depending on the type of banking entity that sponsors or invests in the credit fund, as suggested by a commenter, could result in conflicting requirements for credit funds with multiple banking

[225] Final rule § __.10(c)(15)(ii)(A).

[226] Final rule § __.10(c)(15)(ii)(B).

entity investors and generally increase compliance burdens on credit funds. The agencies also note that activities permitted under § __.10(c)(15) generally would not be considered proprietary trading, provided that an excluded credit fund does not purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefit from actual or expected short-term price movements, realize short-term arbitrage profits, or hedge one or more of the positions resulting from the purchases or sales of financial instruments.

The agencies are not expressly incorporating the permitted activities in §§ __.4, __.5, and __.6 of the implementing regulations into the text of the final credit fund exclusion. The exclusion for credit funds is intended to allow banking entities to share the risks of otherwise permissible lending activities. Accordingly, the agencies would not expect that a credit fund would be formed for the purpose of engaging, or in the ordinary course would be engaged, in the activities permitted under §§ __.4, __.5, and __.6 of the implementing regulations. Nevertheless, to the extent that a credit fund seeks to engage in any of those activities as an exemption from the prohibition on engaging in proprietary trading, as defined in § __.3(b)(1)(i) of the final rule, and does so in compliance with the requirements and conditions of the applicable exemption, then the final rule would not preclude such activities.[227] Similarly, with respect to the exclusions

[227] The agencies recognize, however, that compliance with certain requirements and conditions in §§ __.4, __.5, and __.6 of the implementing regulations may be inapt and/or highly impractical in the context of a credit fund, particularly given the asset and activity restrictions contained in § __.10(c)(15). For example, the exemptions for underwriting and market making-related activities in § __.4 require that a banking entity relying on such exemptions, among other things, be licensed or registered to engage in the applicable activity in accordance with applicable law. Moreover, to the extent that a credit fund is a banking entity with significant trading assets and liabilities (i.e., because it, together with its affiliates and subsidiaries, has trading assets and liabilities that equal or exceed $20 billion over the four previous calendar quarters), it also would be required to maintain a separate compliance program specific to those exemptions.

from the definition of proprietary trading contained in § __.3(d) of the implementing regulations, the agencies note that the trading activities identified in § __.3(d) are by definition not deemed to be proprietary trading, such that the performance by an excluded credit fund of those activities would not be inconsistent with the final credit fund exclusion.[228]

Finally, the agencies are not revising the definition of "asset-backed security" in the implementing regulations. The definition of "asset-backed security" in the implementing regulations specifically refers to the meaning specified in section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)).[229] This definition is used elsewhere in banking law,[230] and banking entities and others in the loan securitization industry have adapted their operations in reliance of the definition contained in the Exchange Act. Moreover, the 2013 rule included the requirement that the fund issue asset backed securities as part of the loan securitization criteria, and banking entities have become familiar with this definition, as they have implemented and utilized the exclusion.

Requirements for a sponsor, investment adviser, or commodity trading advisor

The agencies are adopting the proposed requirements for a sponsor, investment adviser, or commodity trading advisor to an excluded credit fund with one modification.

Investors in a credit fund that a banking entity sponsors or for which the banking entity serves as an investment adviser or commodity trading advisor may have expectations related to the performance of the credit fund that raise bailout concerns. To ensure that these investors are

---

[228] Similarly, trading activity that satisfies the 60-day rebuttable presumption in § __.3(b)(4) would be presumed not to be proprietary trading for these purposes.

[229] Implementing regulations § __.10(d)(2).

[230] *See* 12 CFR §244 (Credit Risk Retention)

adequately informed of the banking entity's role in the credit fund, the final rule requires a banking entity that acts as a sponsor, investment adviser, or commodity trading advisor to an excluded credit fund to provide prospective and actual investors the disclosures specified in § __.11(a)(8) of the implementing regulations.[231]

Second, a banking entity that acts as a sponsor, investment adviser, or commodity trading advisor must 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.[232] The agencies note, contrary to the suggestion of a commenter, that this provision does not apply to any investment adviser or commodity trading advisor to a credit fund who does not also sponsor or acquire an ownership interest in the credit fund. Rather, the requirements in § __.10(c)(15) apply only to a sponsor, investment adviser, or commodity trading adviser that relies on the exclusion to sponsor or acquire an ownership interest in the credit fund. The covered fund provisions in § __.10 of the implementing regulations only affect the operations of banking entities that, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.[233] Thus, the safety and soundness provision only applies to banking entities that sponsor an excluded credit fund or that have an ownership interest in an excluded credit fund and also serve as an investment adviser or commodity trading advisor to the fund.

---

[231] Final rule § __.10(c)(15)(iii)(A). These disclosures include, among other things, that losses are borne solely by investors and not the banking entity, that investors should examine fund documents, and that ownership interests are not insured by the FDIC or guaranteed. Final rule § __.11(a)(8).

[232] Final rule § __.10(c)(15)(iii)(B).

[233] Implementing regulations § __.10(a)(1).

More generally, to clarify an issue raised by some commenters, the agencies note that whether a specific banking entity may use the credit fund exclusion to make or have an otherwise impermissible investment in or relationship with a credit fund is contingent on the permissible activities of the banking entity. That is, the same fund may be a covered fund with respect to one banking entity and an excluded credit fund with respect to a different banking entity. A banking entity continues to be responsible for ensuring that its particular investment, sponsorship, or adviser activities comply with section 13 of the BHC Act and its implementing regulations. This principle applies to paragraphs (iii), (iv), and (v) of the credit fund exclusion.

The final rule moves the requirement that the banking entity must comply with § __.14 of the implementing regulations to § __.10(c)(15)(iii). This organizational change is in response to commenters that requested the agencies confirm that that the § __.14 limitations do not apply to a banking entity that merely invests in a credit fund, as opposed to a banking entity that sponsors or advises the fund. The agencies believe this change is appropriate because the limitations on banking entities' relationships with a covered fund in § __.14 only apply when a banking entity serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund.[234] In addition, the agencies appreciate that mere investment by a banking entity in a credit fund does not raise the type of concerns Super 23A was intended to address, and thus the agencies are applying § __.14 only when a banking entity acts as a sponsor, investment adviser, or commodity trading advisor to a credit fund, in each case as though the credit fund were a covered fund.[235] The limitations in § __.15 of the implementing regulations regarding material conflicts of interest, high-risk investments, and safety and

[234] Final rule § __.14(a)(1).

[235] Final rule § __.10(c)(15)(iii)(C).

soundness and financial stability remain applicable to banking entities' investment in, and relationship with, excluded credit funds.

Additional Banking Entity Requirements

As provided in the 2020 proposal, a banking entity may not rely on the credit fund exclusion if it guarantees the performance of the fund.[236] In a revision to the 2020 proposal, under the final rule a banking entity may not rely on the credit fund exclusion if the fund holds any debt instruments or equities (or rights to acquire an equity security) received on customary terms in connection with loans or debt instruments held by the credit fund that the banking entity is not permitted to acquire and hold directly under applicable federal banking laws and regulations.[237] This change is to clarify, as suggested by a commenter, that this requirement is specific only to federal banking laws and regulations. Whether a credit fund's holdings are permissible for a banking entity to hold under state or foreign laws is not relevant to compliance with section 13 of the BHC Act. That said, the agencies note that banking entities must comply with the laws of the jurisdiction applicable to its activities and operations and should be cognizant of whether a credit fund it sponsors or in which it invests complies with the laws of the jurisdictions in which the credit fund operates.[238]

Investment and Relationship Limits

Finally, the agencies are adopting the proposed provisions related to a banking entity's investment in and relationship with a credit fund with one revision. Under the final rule, a

---

[236] Final rule § __.10(c)(15)(iv).

[237] Final rule § __.10(c)(15)(iv)(B).

[238] For example, banking entities that are organized under state or foreign laws may, depending on the nature of the organization, need to comply with other laws.

banking entity's investment in, and relationship with, the issuer must comply with the limitations in § __.15 of the implementing regulations 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.[239]

In addition, a banking entity's investment in, and relationship with, a credit fund must be conducted in compliance with, and subject to, applicable banking laws and regulations, including the safety and soundness standards applicable to the banking entity.[240] The agencies believe it is important to highlight that the requirements applicable to the banking entity also govern the ability of the banking entity to invest in a fund that relies on the credit fund exclusion as well as the types of transactions that a banking entity may conduct with such funds.[241] This means, for example, that a banking entity that invests in or has a relationship with a credit fund is subject to capital charges and other requirements under applicable banking law.[242]

2. Venture Capital Funds

i. Venture Capital Funds

2020 Proposal

The 2020 proposal included an exclusion for "qualifying venture capital funds."[243] As described in the 2020 proposal, venture capital funds that provide capital to small and start-up

---

[239] Final rule § __.10(c)(15)(v)(A).

[240] Final rule § __.10(c)(15)(v)(B).

[241] The agencies also note that § __.10(c)(15)(v)(B) does not impose any additional burdens and should not generate confusion.

[242] 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.

[243] 2020 proposal § __.10(c)(16).

businesses are covered funds unless they can rely on an exclusion other than section 3(c)(1) or 3(c)(7) to avoid registration under the Investment Company Act of 1940 (Investment Company Act) or qualify for an exclusion under the implementing regulations.

Under the 2020 proposal, the exclusion would have been available to "qualifying venture capital funds," which the 2020 proposal defined as an issuer that meets the definition in 17 CFR 275.203(*l*)-1 (Rule 203(*l*)-1), as well as several additional criteria. Specifically, the agencies proposed to exclude from the definition of covered fund an issuer that:

- Is a venture capital fund as defined in Rule 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 sponsor, investment adviser, or commodity trading advisor to the issuer, and that relies on the exclusion to sponsor or acquire an ownership interest in the qualifying venture capital fund, the banking entity would have been 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 the 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 relied on the exclusion would not have been permitted, directly or indirectly, to guarantee, assume, or otherwise insure the obligations or performance of the issuer. Finally, the 2020 proposal would have required 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.

Comments

Several commenters supported an exclusion for venture capital funds.[244] Some of these commenters argued the Volcker Rule has severely impacted investment in venture funds and businesses and that venture capital is a critical financing source for innovative businesses.[245] These commenters described their view of the positive economic impact of venture capital investment.[246] For example, these commenters said companies funded with venture capital promote research and development and job creation.[247] Similarly, several commenters argued that venture capital investments by banking entities can contribute to economic growth, innovation, and job creation.[248] At least one commenter said increased venture capital investment may increase employment by small employers.[249]

---

[244] Representatives Gonzalez, Steil, Stivers, Barr, Hill, Riggleman, Zeldin, Davidson, Budd, Gooden, Rose, Emmer, Timmons, Posey, Kustoff, and Loudermilk (Gonzalez et al.); Crapo; FSF; SIFMA; CCMC; IIB; Goldman Sachs; Credit Suisse; AIC; National Venture Capital Association (NVCA); ABA; and SAF.

[245] *E.g.*, Gonzalez et al. and NVCA.

[246] Gonzalez et al.; NVCA; and CCMC.

[247] *Id.*

[248] *E.g.*, FSF; SIFMA; and Goldman Sachs.

[249] SAF.

Several commenters said an exclusion for venture capital funds would benefit underserved regions where venture capital funding is not readily available currently.[250] One commenter said venture capital fund sizes are often too small for institutional investors, and banks have historically served an important source of investment for small and regional venture capital funds.[251] This commenter said the loss of banking entities as limited partners in venture capital funds has had a disproportionate impact on cities and regions with emerging entrepreneurial ecosystems areas outside of Silicon Valley and other traditional technology centers.[252] Two commenters noted that an exclusion for venture capital funds would promote investments in and financing to small businesses and start-ups in a broad range of geographic areas, industries, and sectors.[253]

Commenters said that an exclusion for venture capital funds would promote the safety and soundness of banking entities.[254] One commenter said the exclusion would allow banks to diversify and to compete with non-banking entities.[255] Commenters also said that the proposed exclusion allows banking entities to make investments indirectly through a fund structure that they could make directly[256] and incorporates criteria and activity restrictions that address any concerns about safety and soundness or evasion.[257]

---

[250] FSF; SIFMA; CCMC; and NVCA.

[251] NVCA.

[252] *Id*.

[253] FSF and SIFMA.

[254] FSF; SIFMA; and Goldman Sachs.

[255] SIFMA.

[256] NVCA.

[257] FSF and SIFMA.

Several commenters supported defining a qualifying venture capital fund by reference to Rule 203(*l*)-1 as proposed.[258] These commenters also said the rule should not incorporate additional criteria as discussed in the preamble to the 2020 proposal, such as additional limitations on revenues or qualifying investments.[259] These commenters said additional criteria are unnecessary to ensure that the fund is a bona fide venture capital fund and could unnecessarily limit the scope of qualifying venture capital funds.[260] On the other hand, one commenter said the rule should include additional criteria to ensure qualifying venture capital funds serve the public interest and do not cause the harms at which section 13 of the Bank Holding Company Act was directed.[261] One commenter argued defining venture capital fund by reference to Rule 203(*l*)-1 would be too narrow because it would exclude shares of emerging growth companies (EGCs) from being classified as qualifying investments and would not reflect certain companies that operate as venture investors and are exempt from having to register as an investment company but may not meet the technical definition of a venture capital fund under Rule 203(*l*)-1 (e.g., startup incubators).[262]

While supporting an exclusion for qualifying venture capital funds generally, a few commenters recommended revisions to the proposed exclusion.[263] Some commenters proposed changes to the requirement that the fund not engage in any activity that would constitute

---

[258] SIFMA; NVCA; FSF; and ABA.

[259] SIFMA; NVCA; FSF; and ABA.

[260] *Id*.

[261] Better Markets.

[262] CCMC.

[263] FSF and SIFMA.

proprietary trading, under § __.3(b)(1)(i), as if it were a banking entity.[264] One of these commenters said qualifying venture capital funds should be permitted to engage in permitted proprietary trading consistent with §§ __.4, __.5, and __.6 of the implementing regulations.[265] Another commenter said the definition of proprietary trading for funds should be the same as the definition that applies to the banking entity and that having two definitions is not reasonable or cost-effective.[266]

Commenters also supported changes to the requirement that the banking entity's investment in and relationship with qualifying venture capital funds must comply with § __.14 of the implementing regulations. One commenter recommended eliminating the requirement that would apply § __.14 to a banking entity's relationship with a venture capital fund.[267] This commenter said that other proposed conditions adequately address bailout and safety and soundness concerns.[268] Other commenters said the agencies should clarify that § __.14 does not apply to a banking entity that simply invests in a qualifying venture capital fund (as opposed to a banking entity that sponsors or advises the fund).[269]

Other commenters did not support the proposed exclusion for qualifying venture capital funds.[270] One of these commenters said if the agencies do adopt an exclusion for qualifying venture capital funds, the exclusion must include additional requirements to ensure that excluded

---

[264] FSF and SIFMA.

[265] FSF.

[266] SIFMA.

[267] SIFMA.

[268] *Id.*

[269] NVCA and ABA.

[270] Better Markets and Data Boiler. Another commenter said an exemption for venture capital funds was not supported by the 2020 proposal and not permitted under the law. Occupy.

venture capital funds serve the public interest and do not cause the harms at which section 619 of the Dodd-Frank Act was directed. Specifically, this commenter said the rule should: (1) restrict all fund investments to "qualifying investments" or at least very significantly restrict investments in non-qualifying investments (e.g., limit them to no more than five percent of the fund's aggregate capital), (2) impose a minimum securities holding period and portfolio company revenue limitation of $35 million (or a similarly appropriate and low figure) to ensure the fund is truly focused on medium-to-long term venture (as opposed to growth stage) investments, and (3) quantitatively limit the use of leverage as a key means for distinguishing excluded venture capital funds from statutorily prohibited activities involving private equity funds.[271]

Final Exclusion

The final rule adopts the proposed exclusion for qualifying venture capital funds with one clarifying change. The exclusion for qualifying venture capital funds will be available to an issuer that:

- Is a venture capital fund as defined in Rule 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. [272]

With respect to any banking entity that acts as sponsor, investment adviser, or commodity trading advisor to the issuer, and that relies on the exclusion to sponsor or acquire an ownership interest in the qualifying venture capital fund, the banking entity will 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;

[271] Better Markets.

[272] Final rule § __.10(c)(16)(i).

- Ensure that the activities of the issuer are consistent with the safety and soundness standards that are substantially similar to those that would apply if the banking entity engaged in the activities directly; and
- Comply with the restrictions imposed in § __.14 (except the banking entity may acquire and retain any ownership interest in the issuer), as if the issuer were a covered fund.[273]

Like the 2020 proposal, a banking entity that relies on the exclusion may not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the issuer. [274]

Finally, like the 2020 proposal, the final rule requires a banking entity's ownership interest in or relationship with a qualifying venture capital fund to:

- Comply with the limitations imposed in § __.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.[275]

The agencies believe the exclusion for qualifying venture capital funds will support capital formation, job creation, and economic growth, particularly with respect to small businesses and start-up companies. These banking entity investments in qualifying venture capital funds can benefit the broader financial system by improving the flow of financing to small businesses and start-ups. The agencies expect that the new exclusion for qualifying

[273] Final rule § __.10(c)(16)(ii).

[274] Final rule § __.10(c)(16)(iii).

[275] Final rule § __.10(c)(16)(iv).

venture capital funds will provide banking entities with an additional avenue for providing funding to smaller businesses, which can help to support job creation and economic growth.

As described further below, the requirements of the exclusion, including the SEC's definition of venture capital fund in Rule 203(*l*)-1, address the concerns the agencies expressed in the preamble to the 2013 rule that the activities and risk profiles of 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 determined these requirements will 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.

An exclusion for qualifying venture capital funds is permitted by the statutory language of section 13 of the BHC Act. As the agencies discussed in the preamble to the 2013 final rule, the language, structure, and purpose of section 13 of the BHC Act authorize the agencies to adopt a tailored definition of "covered fund" that focuses on vehicles used for purposes that were the target of the funds prohibition.[276] The agencies do not believe the fact that Congress expressly distinguished venture capital funds from other types of private funds in other contexts is dispositive. In this context, the agencies 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 exclusion. Rather, the text of section 619 and the Dodd-Frank Act as a whole indicate that venture capital funds were not the intended target of the funds prohibition. The plain language of the statutory prohibition applies to hedge funds and private equity funds.[277] This language is silent with respect to venture capital funds. In Title IV of the Dodd-Frank Act, Congress

[276] 79 FR 5671.

[277] 12 U.S.C. 1851(a)(1)(B).

mandated specific treatment for venture capital funds for purposes of the registration requirements under the Investment Advisers Act of 1940 ("Advisers Act").[278] This provision suggests that Congress knew how to accord specific treatment for venture capital funds. Yet, Congress did not list venture capital funds among the types of funds that were restricted under section 13.[279] That Congress did not intend to prohibit venture capital fund investments is further supported by the legislative history of section 13, in which several Members of Congress specifically addressed venture capital funds in the context of the funds prohibition.[280]

---

[278] 15 U.S.C. 80b-3(*l*).

[279] In the preamble to the 2013 final rule, the agencies cited to Congressional reports related to Title IV that characterized venture capital funds as "a subset of private investment funds specializing in long-term equity investment in small or start-up businesses." 79 FR 5704 (quoting S. Rep. No. 111-176 (2010)). However, there is no indication in the statutory text itself that Congress intended to treat venture capital funds identically to private equity funds. Moreover, 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"). The difference between these two terms—specifically, the broader term "private funds" used in Title IV—may indicate why Congress found it necessary to exclude venture capital explicitly in section 407 but not in section 619.

[280] *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. 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)…"); and 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

Like the 2020 proposal, the final rule incorporates the definition of venture capital fund from Rule 203(*l*)-1. Most commenters accepted or supported the proposed approach to incorporate the definition of venture capital fund in Rule 203(*l*)-1.[281] For the reasons discussed in the 2020 proposal,[282] the agencies believe this definition accurately identifies venture capital funds and addresses the concerns the agencies identified in declining to adopt an exclusion for venture capital funds in the 2013 rule.

The SEC has defined "venture capital fund" as any private fund[283] 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

---

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.").

[281] SIFMA; NVCA; FSF; ABA; and Goldman Sachs.

[282] 85 FR 12135-12136.

[283] 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, but for section 3(c)(1) or 3(c)(7) of that Act." 15 U.S.C. 80b-2(a)(29).

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, and has not elected to be treated as a business development company pursuant to section 54 of that Act.[284]

"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).[285]

"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

[284] 17 CFR 275.203(*l*)–1(a).

[285] 17 CFR 275.203(*l*)–1(c)(3).

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.[286] 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 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.[287]

In the preamble to the regulation 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.[288] 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

---

[286] 17 CFR 275.203(*l*)–1(c)(4).

[287] *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).

[288] 76 FR 39656.

buyout funds.[289] 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.[290]

This definition of venture capital fund 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. Further, 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 the public markets.[291] These characteristics 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.

One commenter said requiring that a fund satisfy the requirements of Rule 203(*l*)-1 would have the effect of making the exclusion too narrow. This commenter said the exclusion

---

[289] *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").

[290] 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.").

[291] 76 FR 39662.

for qualifying venture capital funds should permit investments in EGCs and, more generally, should "reflect the evolving nature of the venture capital industry and not rely solely on the existing SEC definition."[292] The final rule does not modify the requirement that a qualifying venture capital fund must satisfy the requirements of Rule 203(*l*)-1. These requirements focus the exclusion on the types of less mature and start-up portfolio companies that characterize traditional venture capital activities. At the same time, the definition of qualifying venture capital fund does not preclude investments in EGCs because a qualifying venture capital fund could make investments in EGCs within the 20 percent limit for non-qualifying investments. Because the requirement that a qualifying venture capital fund must satisfy the requirements of Rule 203(*l*)-1 does not preclude investments in EGCs and helps to distinguish qualifying venture capital funds from the type of funds that section 13 of the BHC Act was intended to restrict, the agencies have determined to adopt the requirement that a qualifying venture capital fund must be a venture capital fund as defined in Rule 203(*l*)-1.

The final rule adopts the requirement that a qualifying venture capital fund may not engage in any activity that would constitute proprietary trading under § __.3(b)(1)(i), as if the issuer were a banking entity.[293] As described in the 2020 proposal, this requirement helps to promote the specific purposes of section 13 of the BHC Act.[294] The agencies are not adopting any changes to this requirement, as recommended by some commenters. The agencies are not expressly incorporating the permitted activities in §§ __.4, __.5, and __.6 of the implementing regulations into the text of the qualifying venture capital fund exclusion. The exclusion for

---

[292] CCMC.

[293] Final rule § __.10(c)(16)(i)(B).

[294] 85 FR 12136.

qualifying venture capital funds is intended to allow banking entities to share the risks of otherwise permissible long-term venture capital activities. Accordingly, the agencies would not expect that a qualifying venture capital fund would be formed for the purpose of engaging, or in the ordinary course would be engaged, in the activities permitted under §§ __.4, __.5, and __.6 of the implementing regulations. Moreover, such activities could reflect a purpose other than making long-term venture capital investments. Nevertheless, to the extent that a qualifying venture capital fund seeks to engage in any of those activities as an exemption from the prohibition on engaging in proprietary trading, as defined in § __.3(b)(1)(i) of the final rule, and does so in compliance with the requirements and conditions of those permitted activities, then the final rule would not preclude such activities.[295] Similarly, with respect to the exclusions from the definition of proprietary trading in § __.3(d) of the implementing regulations, the agencies note that that the trading activities identified in § __.3(d) are by definition not deemed to be proprietary trading, such that the performance by an qualifying fund of those activities would not be inconsistent with the final qualifying venture capital fund exclusion.[296]

---

[295] As the agencies noted in the discussion of the final credit fund exclusion, compliance with certain requirements and conditions in __.4, __.5, and __.6 of the implementing regulations may be inapt and/or highly impractical in the context of a qualifying venture capital fund, particularly given the activity restrictions contained in § __.10(c)(16). For example, the exemptions for underwriting and market making-related activities in __.4 require that a banking entity relying on such exemptions, among other things, be licensed or registered to engage in the applicable activity in accordance with applicable law. Moreover, to the extent that a qualifying venture capital fund is a banking entity with significant trading assets and liabilities (*i.e.*, because it, together with its affiliates and subsidiaries, has trading assets and liabilities that equal or exceeds $20 billion over the four previous calendar quarters), it also would be required to maintain a separate compliance program specific to those exemptions.

[296] Similarly, and consistent with the discussion of the final credit fund exclusion, trading activity that satisfies the 60-day rebuttable presumption in § __.3(b)(4) would be presumed not to be proprietary trading for these purposes.

The final rule does not define proprietary trading by reference to the prong of paragraph __.3(b)(1) that would apply to the banking entity, as recommended by some commenters, because the agencies do not believe this change would be effective or simplify the exclusion. Unlike some banking entities, venture capital funds (that are not themselves banking entities) are not subject to the market risk capital rule, and thus there is generally no need to evaluate a venture capital fund's investments under the market risk capital framework. Moreover, applying the prong that would apply to the relevant banking entity could result in one venture capital fund becoming subject to both prongs. The agencies believe this would complicate evaluation of a qualifying venture capital fund's eligibility for the exclusion, both for banking entities and the agencies. The agencies do not agree with one commenter's argument that requiring funds sponsored by banking entities that are subject to the market risk capital rule test to apply the short-term intent test for purposes of the covered funds provisions would introduce unnecessary complexity and compliance costs for these banking entities. As the agencies described in the preamble to the 2019 final rule, the Federal banking agencies' market risk capital rule[297] incorporates the same short-term intent standard as the short-term intent test in § __.3(b)(1)(i).[298] Therefore, market risk capital rule covered banking entities continue to apply the short-term intent standard as part of their compliance with the market risk capital rule. Similar processes may be employed to apply the short-term intent standard to qualifying venture capital funds.

The final rule adopts the requirement that a banking entity that serves as a sponsor, investment adviser, or commodity trading advisor to a qualifying venture capital fund may not rely on the exclusion for qualifying venture capital funds unless it provides the disclosures

---

[297] *See* 12 CFR part 3, subpart F; part 217, subpart F; part 324, subpart F.

[298] 84 FR 61986.

required under § __.11(a)(8) to prospective and actual investors in the fund. This requirement promotes one of the purposes of section 13 of the BHC Act, which is to prevent banking entities from bailing out funds that they sponsor or advise. The final rule also adopts the requirement that a banking entity that serves as a sponsor, investment adviser, or commodity trading advisor to a qualifying venture capital fund must ensure the activities of the qualifying venture capital fund are consistent with safety and soundness standards that are substantially similar to those that would apply if the banking entity engaged in the activity directly. Therefore, a banking entity may not rely on this exclusion to sponsor or invest in 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.

In the final rule, the requirement that the banking entity must comply with § __.14 of the implementing regulations is moved to § __.10(c)(16)(ii). This change clarifies that this requirement applies to a banking entity that acts as sponsor, investment adviser, or commodity trading adviser to the qualifying venture capital fund and does not apply to a banking entity that merely invests in a qualifying venture capital fund.

The final rule does not eliminate the requirement that a banking entity's investment in or relationship with a qualifying venture capital fund must comply with § __.14 of the implementing regulations, as recommended by one commenter. The agencies do not agree that applying the requirements of § __.14 is duplicative of the requirement that the banking entity not directly or indirectly guarantee, assume, or otherwise insure the obligations or performance of the issuer. In addition to prohibiting guarantees, § __.14 also prohibits other types of transactions that function as extensions of credit or that could raise the type of bail-out concerns that section 13 of the BHC Act was intended to address. The agencies also do not agree that

applying the requirements of § __.14 is duplicative of the requirement that the banking entity's investment in and relationships with the qualifying venture capital fund must comply with the backstop provisions in § __.15. The backstop provisions in § __.15 address high-risk assets and high-risk trading strategies, and material conflicts of interest, but do not address extensions of credit that may not entail a "substantial financial loss" to the banking entity. The agencies do not expect that applying § __.14 to a banking entity that sponsors or advises a qualifying venture capital fund will unduly interfere with the effectiveness of the exclusion. The final rule incorporates revisions to § __.14 that will improve banking entities' ability to enter into certain ordinary course transactions with sponsored and advised funds.[299] The agencies expect these changes will mitigate concerns that applying the requirements of § __.14 to qualifying venture capital funds will limit the exclusion's utility.[300]

The final rule adopts the requirement that the banking entity must not guarantee, assume, or otherwise insure the obligations or performance of a qualifying venture capital fund.[301] The final rule also adopts the requirements that a banking entity's ownership in or relationship with a qualifying venture capital fund must comply with the limitations in § __.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.[302] These requirements promote several of the purposes of section 13 of the BHC Act.

---

[299] *See infra*, Section IV.D (Limitations on Relationships with a Covered Fund).

[300] The commenter that recommended eliminating the requirement that the banking entity's investment in or relationship with a qualifying venture capital fund said that doing so would "limit the utility and related benefits of the qualifying venture capital fund exclusion, regardless of the proposed new exceptions to Super 23A." SIFMA. However, the commenter did not provide any examples or further explain how the utility of the exclusion would be impacted.

[301] Final rule § __.10(c)(16)(iii).

[302] Final rule § __.10(c)(16)(iv).

The requirement that the banking entity not guarantee, assume, or otherwise ensure the obligations or performance of a qualifying venture capital fund promotes the purpose of preventing banking entities from bailing out the fund. The requirements that a banking entity's ownership in or relationship with a qualifying venture capital fund must comply with the limitations in § __.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, prevent a qualifying venture capital fund from being used to expose a 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. To the extent a fund would expose a banking entity to a high-risk assets or a high-risk trading strategy, 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 do not believe that any additional conditions to the exclusion for qualifying venture capital funds are necessary. One commenter said that the exclusion should (1) restrict all fund investments to "qualifying investments" or at least very significantly restrict investments in non-qualifying investments (e.g., limit them to no more than five percent of the fund's aggregate capital), (2) impose a minimum securities holding period and portfolio company revenue limitation of $35 million (or a similarly appropriate and low figure) to ensure the fund is truly focused on medium-to-long term venture (as opposed to growth stage) investments, and (3) quantitatively limit the use of leverage as a key means for distinguishing excluded venture

capital funds from statutorily prohibited activities involving private equity funds.[303] The agencies have determined not to impose any additional criteria for the reasons discussed below.

First, the agencies decline to limit a qualifying venture capital fund's non-qualifying investments to five percent or less of total assets. The agencies agree with commenters that it is necessary to provide some amount of flexibility for a venture capital fund to make investments that deviate from the typical form of venture capital investment activity. For example, the agencies understand that certain common venture capital fund activities, such as secondary acquisition of portfolio company shares from founders, are not qualifying investments under Rule 203(*l*)-1. The agencies agree with commenters, as well as with the rationale the SEC provided in the 2011 adopting release, that said providing flexibility for this type of non-qualifying investment is consistent with the overall goal of identifying funds engaged in a venture capital strategy. In making this determination, the agencies find it significant that the SEC considered this issue as part of its 2011 rulemaking and concluded that a 20 percent bucket for non-qualifying investments was appropriate.[304] Moreover, all activities of a qualifying venture capital fund, including any investments that would be non-qualifying investments under Rule 203(*l*)-1, will be subject to the other requirements in § __.10(c)(16), including the requirement that the fund not engage in proprietary trading and not result in a material exposure by the banking entity to a high-risk asset or high-risk trading strategy.

The agencies also decline to impose additional requirements, such as a minimum securities holding period or a portfolio company revenue limitation. The agencies believe a minimum securities holding period is unnecessary in light of the requirements that the fund (1)

---

[303] Better Markets.

[304] 76 FR 39683.

represent to investors and potential investors that it pursues a venture capital strategy[305] and (2) not engage in any activity that would constitute proprietary trading under § __.3(b)(1)(i), as if it were a banking entity.[306]

The agencies also considered whether to include a portfolio company revenue limitation, as discussed in the preamble to the 2020 proposal. Most commenters did not support imposing a revenue limitation, while one commenter supported imposing a limitation of $35 million. After considering all comments received, the agencies determined that a revenue limit could unnecessarily disadvantage certain companies because the revenues of startups can vary greatly based on industry and geography. The agencies determined it would be unnecessarily restrictive to create a revenue limit that could limit funding to otherwise eligible portfolio companies. Again, the agencies found it significant that the SEC expressly considered this issue as part of the 2011 rulemaking and determined that any "single factor test could ignore the complexities of doing business in different industries or regions" and "could inadvertently restrict venture capital funds from funding otherwise promising young small companies."[307] In addition, the definition of "qualifying portfolio company" in the SEC's rule incorporates appropriate standards that distinguish newer ventures from more established companies. In particular, a "qualifying portfolio company" may not be "reporting or foreign traded" and may not control, be controlled by or under common control with another company that is reporting or foreign traded.[308] A "reporting or foreign traded" company for these purposes means a company that is subject to the

---

[305] 17 CFR 275.203(*l*)-(1)(a)(1).

[306] Final rule § __.10(c)(16)(i)(B).

[307] 76 FR 39649.

[308] 17 CFR 275.203(*l*)-1(c)(4).

reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 or having a security listed or traded on any exchange or organized market operating in a foreign jurisdiction.[309] In addition to publicly offered companies, this definition excludes issuers if they have more than $10 million in total assets and a class of equity securities, such as common stock, that is held of record by either 2,000 or more persons or 500 or more persons who are not accredited investors.[310] In adopting the "reporting or foreign traded" requirement of Rule 203(*l*)-1, the SEC explained that it found "a key consideration by Congress" was that venture capital funds "are less connected with the public markets and may involve less potential systemic risk."[311] This condition that qualifying portfolio companies not be capitalized by the public markets serves to limit the type of companies in which a qualifying venture capital fund may invest.

Finally, the agencies determined it is unnecessary to include an additional quantitative limit on the use of leverage because the exclusion incorporates a leverage limit. Specifically, Rule 203(*l*)-1 provides that a venture capital fund may not borrow or otherwise incur leverage in excess of 15 percent of the fund's aggregate capital contributions and uncalled capital commitments, and then only on a short-term basis. Because the exclusion already incorporates a limit on leverage for a qualifying venture capital fund, it is not necessary for the final rule to incorporate an additional limit on leverage.

---

[309] 17 CFR § 275.203(l)-1(c)(5).

[310] 15 U.S.C. 78*l*(g).

[311] 76 FR 39656.

ii. Long-Term Investment Funds

In the preamble to the 2020 proposal, the agencies asked whether the final rule should include an exclusion for long-term investment funds. In the preamble, the agencies asked if an exclusion should be provided 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 Rule 203(*l*)-1.

Several commenters supported an exclusion for long-term investment funds.[312] Many of these commenters said an exclusion for qualifying long-term investment funds would help to close gaps in the availability of financing that exist under the implementing regulations while promoting and protecting the safety and soundness of the banking entity and the financial

[312] Gonzalez et al.; Crapo; FSF; SIFMA; CCMC; CCMR; IIB; Goldman Sachs; AIC; and ABA. One commenter said the final rule should exclude an issuer with the following characteristics: (1) its investment strategy or business purpose is to invest in assets in which a financial holding company would be permitted to invest directly; (2) it holds itself out to investors as acquiring and holding long-term assets for at least two years; (3) it does not engage in activities that would constitute impermissible proprietary trading (as defined in the implementing regulations) if conducted directly by a banking entity; and (4) if it is sponsored by a banking entity, (A) the sponsoring banking entity and its affiliates cannot, directly or indirectly, guarantee, assume or otherwise insure its obligations, (B) it must comply with the disclosure obligations under § __.11(a)(8) of the rule and (C) the sponsoring banking entity must comply with the limitations imposed by § __.14 (except that the banking entity may acquire and retain any ownership interest in the issuer) and § __.15, as if the vehicle were a covered fund. The commenter said these conditions would adequately address concerns regarding evasion, promote long-term capital formation, and exclude certain entities that are inadvertently captured by the definition of "covered fund" such as certain incubators. Goldman Sachs.

stability of the U.S.[313] These commenters said the exclusion would allow banking entities to diversify their assets and income streams, thereby reducing the overall risk of their assets and operations and increasing their resiliency against failure.[314] Several of these commenters supported an exclusion for long-term investment funds because they said it would allow banking entities to do indirectly through a fund structure the same activities they may conduct directly.[315] Some commenters said long-term investment vehicles do not engage in short-term proprietary trading or the high-risk activities that section 619's backstop provisions are intended to address.[316]

One commenter said the rule should not establish an exclusion for long-term investment vehicles because section 619 of the Dodd-Frank Act was put in place to reorient banks away from risky speculative activities and toward responsible lending to businesses and households.[317]

The final rule does not include an exclusion for long-term investment funds. After reviewing all comments received, the agencies determined that it remains difficult to distinguish effectively such funds from the type of funds that section 13 of the BHC Act was designed to restrict. A general exclusion for long-term investment funds would be too broad of an approach for addressing specific types of issuers, such as inadvertent investment companies and incubators

---

[313] SIFMA; AIC; and CCMR. One commenter said an exclusion for long-term investment funds is necessary because the proposed exclusion for qualifying venture capital funds would not address incubators and other issuers that do not hold themselves out as pursuing a venture capital strategy. Goldman Sachs. Two commenters said excluding long-term investment funds would provide certainty for banking entities that hold interests in "inadvertent" or "accidental" investment companies. SIFMA and Goldman Sachs.

[314] *Id.*

[315] FSF; CCMR; AIC; CCMC; and SIFMA.

[316] ABA and CCMC.

[317] Robert Rutowski.

that do not hold themselves out as engaging in a venture capital strategy, as described by some commenters. An exclusion based primarily on the length of time that an issuer holds its investments could be overbroad because it could also permit funds that are engaged in the type of investment activity that section 13 of the BHC Act was designed to restrict. Moreover, the agencies believe the exclusions for credit funds and qualifying venture capital funds will improve banking entities' ability to provide long-term financing through certain fund structures in a manner that is consistent with the statute.

3. Family Wealth Management Vehicles

The agencies are adopting an exclusion from the definition of "covered fund" under § __.10(b) of the rule for any entity that acts as a "family wealth management vehicle." This exclusion is available to an 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. For family wealth management vehicles that are trusts, the grantor(s) must be family customers.[318] For non-trust family wealth management vehicles, family customers must own a majority of the voting interests (directly or indirectly) as well as a majority of interests in the entity. Ownership of non-trust family wealth management vehicles is generally limited to family customers and up to five closely related

[318] Under § __.10(c)(17)(iii)(B) of the final rule, a "family customer" is 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, or a spouse or spousal equivalent of any of the foregoing. 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 family wealth management vehicle exclusion.

persons of the family customers.[319] However, there is a *de minimis* ownership allowance that permits one or more entities, including a banking entity, that are not family customers or closely related persons, to acquire or retain, as principal, up to an aggregate 0.5 percent of the family wealth management vehicle's outstanding ownership interests for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.[320]

In addition, a banking entity may rely on the exclusion only if the banking entity: (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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity; (4) does not acquire or retain, as principal, an ownership interest in the entity, other than up to an aggregate 0.5 percent of the family wealth management vehicle's outstanding ownership interests 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 entity were a covered fund; and (6) except for riskless principal transactions as defined in §

[319] Under § __.10(c)(17)(iii)(A) of the final rule, "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."

[320] This 0.5 percent ownership interest represents the aggregate amount of a family wealth management vehicle's ownership interests that may be acquired or retained by all entities that are neither a family customer nor a closely related person.

__.10(d)(11),[321] complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity were an affiliate thereof.[322]

In the 2020 proposal, the agencies requested comment on whether to exclude family wealth management vehicles from the definition of "covered fund."[323] Several commenters supported this exclusion stating, generally, that it would reduce uncertainty for banking entities about the permissibility of providing traditional banking, investment management, and trust and estate planning services to family wealth management vehicle clients.[324] As discussed below, other commenters opposed the exclusion or recommended revisions to it.[325]

The agencies believe that the exclusion for family wealth management vehicles will 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.[326] The

---

[321] "Riskless principal transaction" means a transaction in which a banking entity, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer. Final rule § __.10(d)(11). The allowance for riskless principal transactions in the final rule does not affect the independent application of the Board's Regulation W (12 CFR Part 223).

[322] Final rule § __.10(c)(17)(ii).

[323] 85 FR 12120.

[324] *See, e.g.*, Goldman Sachs; FSF; CCMR; IAA; ABA; BPI; PNC; and SIFMA.

[325] *See, e.g.*, Better Markets, Data Boiler; SIFMA; BPI; ABA.

[326] Several commenters supported the exclusion, with two stating that many family wealth management vehicles do not rely on the exclusions in 3(c)(1) and (c)(7) of the Investment Company Act and are not covered funds under the implementing regulations. *See* ABA and PNC. Banking entities that sponsor or invest in family wealth management vehicles that are not subject to the covered funds provisions under section 13 of the BHC Act or the implementing regulations would not need to rely on this exclusion.

agencies believe the exclusion for family wealth management vehicles will 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 of the BHC Act was designed to address. As the agencies noted in the preamble to the 2013 rule, section 13 and the implementing regulations were designed in part to permit banking entities to continue to provide client-oriented financial services, including asset management services.[327] Furthermore, the agencies believe that the provisions of the exclusion will work together to sufficiently reduce the likelihood that these vehicles could be used to evade the requirements of section 13 or the implementing regulations.

One of the commenters that opposed the exclusion expressed concern with the agencies adding an exclusion from the definition of "covered fund" that they believed would only benefit a few wealthy families.[328] Banking entities may provide asset management services to families through a trust structure. The agencies believe that banking entities should have flexibility to offer such asset management services to families through a fund structure subject to appropriate limits. As noted above, the agencies believe the exclusion for family wealth management vehicles will 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.

---

[327] *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.").

[328] *See* Better Markets.

The agencies continue to believe that the 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.[329] The exclusion will 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.

Another commenter suggested that, rather than providing an exclusion for family wealth management vehicles through a rulemaking, the agencies should instead provide no-action relief on a case-by-case basis.[330] The agencies do not believe that a case-by case approach would further the aims of section 13 or the implementing regulations. The agencies believe that a case-by-case approach would be unnecessarily burdensome and difficult to administer. This approach would also unnecessarily deviate from the agencies' treatment of other excluded entities under the implementing regulations and hinder transparency and consistency.

The agencies believe that the adopted exclusion for a family wealth management vehicle will appropriately distinguish it from the type of entity that the covered funds provisions of section 13 of the BHC Act were intended to capture. The exclusion requires 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 exclusion will help to differentiate family wealth management vehicles from covered funds, which raise money from investors for this purpose.

---

[329] 12 U.S.C. § 1851(d)(1)(D).

[330] Data Boiler.

In addition, the family wealth management vehicle exclusion contains ownership limits designed to ensure that the vehicle is used to manage the wealth and other assets of customers and their families. One such limit is the definition of "family customer." As proposed, the definition of "family customer" is based on the definition of "family client" in rule 202(a)(11)(G)-1(d)(4) under the Advisers Act (the family office rule), and also incorporates certain in-laws and their spouses and spousal equivalents. Several commenters supported this approach,[331] however, one commenter suggested that the agencies exclude in-laws, their spouses and their spousal equivalents from the definition of "family customer."[332] The agencies believe that in-laws, their spouses and spousal equivalents share the same close familial relations as others included in the definition of "family client." Furthermore, the agencies believe that the final rule's definition of "family customer" reflects the types of relationships typically present in family wealth management vehicles.[333] Reflecting those relationships prevents unnecessary constraints on the utility of the exclusion and will allow banking entities to provide traditional banking services to these clients.

Another ownership limit designed to ensure that a family wealth management vehicle is used to manage the wealth and other assets of customers and their families is the requirement that a majority of the interests in the entity are owned by family customers.[334] The inclusion of this limit in the final rule is a modification from the 2020 proposal which only required family customers to own a majority of the voting interests (directly or indirectly) in the entity. One

---

[331] *See, e.g.*, SIFMA; BPI; and ABA.

[332] *See* Better Markets.

[333] *See, e.g.*, SIFMA; BPI; and ABA.

[334] Final rule § __.10(c)(17)(i)(B)(2).

commenter suggested this modification to ensure that the exclusion is not used to evade the intent of section 13 and the implementing regulations.[335] The agencies believe this modification is an appropriate means of ensuring that the exclusion is used by banking entities that are providing services to family wealth management vehicles, rather than to hedge funds or private equity funds.

Another commenter suggested additional ownership limits for family wealth management vehicles, including limits on the vehicle's ability to restructure, to prevent evasion of the prohibitions of section 13 and the implementing regulations.[336] However, as discussed above, the agencies believe that the requirements of the exclusion, along with the conditions a banking entity must meet in order to rely on it, will help to ensure that banking entities will not be able to use family wealth management vehicles as a means to evade section 13 and the implementing regulations.

Another ownership limit designed to ensure that a family wealth management vehicle is used to manage the wealth and other assets of customers and their families is the requirement that only up to five closely related persons of family customers may hold ownership interests in the vehicle.[337] The agencies proposed to permit three closely related persons to hold ownership interests. Several commenters supported allowing a finite number of closely related persons of family customers to hold ownership interests.[338] However, some commenters suggested that the proposed limit of three closely related persons did not reflect the typical manner in which family

---

[335] *See* ABA.

[336] *See* Data Boiler.

[337] Final rule § __.10(c)(17)(i)(B)(3).

[338] *See, e.g.*, BPI; SIFMA; PNC; and ABA.

wealth management vehicles are constituted and would unnecessarily constrain the availability of the exclusion.[339] These commenters recommended that the agencies modify the proposed rule to allow for up to ten closely related persons to invest in family wealth management vehicles.[340] One of these commenters stated that increasing the number of closely related persons would allow banking entities to provide traditional wealth management and estate planning services to family wealth management vehicles and that the other conditions imposed by the proposed rule would keep such vehicles from evading the covered fund provisions of the implementing regulations.[341] The commenter further noted that a limit of ten closely related persons would align the exclusion with the numerical limitation of unaffiliated owners provided for in the joint venture exclusion.[342]

The final rule will allow up to five closely related persons to hold ownership interests in a family wealth management vehicle. Commenters indicated that many family wealth management vehicles currently include more than three closely related persons.[343] The agencies believe that the final rule will more closely align the exclusion with the current composition of family wealth management vehicles, thereby increasing the utility of the exclusion without allowing such a large number of non-family customer owners to suggest the entity is in reality a hedge fund or private equity fund. Additionally, the agencies believe that requiring family

---

[339] *See, e.g.*, BPI; SIFMA; ABA; and PNC.

[340] *See, e.g.*, SIFMA; BPI; ABA; and PNC.

[341] *See* SIFMA.

[342] *See* SIFMA.

[343] *See, e.g.*, BPI; ABA; and PNC.

customers to own a majority of the interests in the family wealth management vehicle will serve as an additional safeguard against evasion of the provisions of section 13 of the BHC Act.

As proposed, the final rule's definition of "closely related person" is "a natural person (including the estate and estate planning vehicles of such person) who has longstanding business or personal relationships with any family customer."[344] One commenter suggested that the definition of "closely related person" should include only persons with personal relationships with family customers and not also business relationships.[345] The agencies believe that it is not practical or worthwhile to exclude business relationships from the definition of "closely related person" because it would require banking entities to engage in an assessment of relationships that are likely to include elements common in both personal and business relationships. The agencies also believe that requiring these relationships to be "longstanding" will help ensure that they are bona fide established relationships and not simply related to the planned investment activities through the family wealth management vehicle.

In a change to the 2020 proposal, the final rule permits any entity, or entities—not only banking entities—to acquire or retain, as principal, up to an aggregate 0.5 percent of the entity's outstanding ownership interests, for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.[346] Some commenters requested that the agencies include this modification because often, family wealth management vehicles use unaffiliated third parties—such as third-party trustees or similar service providers—when structuring family wealth management vehicles.[347] The agencies

---

[344] Final rule § __.10(c)(17)(iii)(A).

[345] *See, e.g.*, Better Markets.

[346] Final rule § __.10(c)(17)(i)(C).

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

believe that permitting *de minimis* ownership by non-banking entity third parties is appropriate and in some cases necessary to reflect the typical structure of family wealth management vehicles. The *de minimis* ownership provision recognizes that ownership by an entity other than a family customer or closely related person may be necessary under certain circumstances – such as establishing corporate separateness or addressing bankruptcy, insolvency, or similar matters. Whether the entity that owns a *de minimis* amount is a banking entity or some other third party does not raise any concerns that are not sufficiently addressed by the aggregate ownership limit and the narrow circumstances in which such entities may take an ownership interest. The agencies recognize that without this modification, family wealth management vehicles may be forced to engage in less effective and/or efficient means of structuring and organization because the exclusion would limit the vehicle's access to some customary service providers that have traditionally taken small ownership interests for structuring purposes. The agencies are therefore expanding the types of entities that may acquire or retain the *de minimis* ownership interest to include any third party. However, the aggregate *de minimis* amount and the purpose for which it may be owned is unchanged from the 2020 proposal.

As stated above, under the final rule, a banking entity may only rely on the exclusion with respect to a family wealth management vehicle if the banking entity meets certain conditions.[348] The agencies believe that, collectively, the conditions of the exclusion will help to ensure that family wealth management vehicles are used for client-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 conditions are based on

[348] Final rule § __.10(c)(17)(ii).

existing conditions in other provisions of the implementing regulations,[349] which the agencies believe will facilitate banking entities' compliance with the exclusion.

As proposed, the agencies are not applying § __.14(a), which applies section 23A of the Federal Reserve Act to banking entities' relationships with covered funds, to family wealth management vehicles because the agencies understand that the application of § __.14(a) to family wealth management vehicles could prohibit banking entities from providing the full range of banking and asset management services to customers using these vehicles.[350] The agencies are, however, applying §§ __.14(b) and ___.15 to family wealth management vehicles, as proposed, because the agencies continue to believe that it will help ensure that banking entities and their affiliates' exposure to risk remains appropriately limited.

The agencies are also adopting a prohibition, with modifications described below, on banking entity purchases of low-quality assets from family wealth management vehicles that would be prohibited under Regulation W concerning transactions with affiliates (12 CFR 223.15(a))—as if such banking entity were a member bank and the entity were an affiliate

---

[349] *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).

[350] *See* SIFMA (stating that it agreed with the agencies' approach of not applying § __.14 to relationships between banking entities and family wealth management vehicles because doing so would prevent banking entities from making ordinary extensions of credit and entering into a number of other transactions with family wealth management vehicles that are critical to the banking entity providing traditional asset management and estate planning services).

thereof—to prevent banking entities from "bailing out" family wealth management vehicles.[351] Regulation W (12 CFR 223.15(a)) provides that a member bank may not purchase a low-quality asset from an affiliate unless, pursuant to an independent credit evaluation, the member bank had committed itself to purchase the asset before the time the asset was acquired by the affiliate.[352] Several commenters requested clarification that the exclusion permits banking entities to engage in riskless principal transactions to purchase assets—including low quality assets for purposes of section 223.15 of the Board's Regulation W—from family wealth management vehicles.[353] Commenters stated that the need for such asset purchases may arise as a result of a family customer's preferences and that permitting the banking entities to engage in such purchases may facilitate the family customer's sale of the asset.[354] Commenters stated that allowing these transactions would pose minimal market or credit risk to a banking entity because the banking entity would purchase and sell the same asset contemporaneously.[355] Furthermore, one commenter stated that without clarity on the permissiveness of riskless principal transactions, family wealth management vehicles would be forced to obtain the services of a third-party service provider to sell low quality assets, which would increase costs and operational complexity of the family wealth management vehicles without furthering the aims of section 13 of the BHC Act or the implementing regulations.[356]

---

[351] Final rule § __.10(c)(17)(ii)(F).

[352] 12 CFR 223.15(a).

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

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

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

[356] *See* SIFMA.

The agencies believe that permitting a banking entity to engage in riskless principal transactions that involve the purchase of low-quality assets from a family wealth management vehicle is unlikely to pose a substantive risk of evading section 13 of the BHC Act. In a riskless principal transaction, the riskless principal (the banking entity) buys and sells the same security contemporaneously, and the asset risk passes promptly from the customer (family wealth management vehicle, in this context) through the riskless principal to a third-party.[357] The agencies are adopting the condition that banking entities and their affiliates comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity were an affiliate. However, in a change from the 2020 proposal and in response to the concerns raised by commenters, the condition will explicitly exclude from those requirements transactions that meet the definition of riskless principal transactions as defined in § __.10(d)(11). The definition of riskless principal transactions adopted in § __.10(d)(11) is similar to the definition adopted in the Board's Regulation W, as this definition is appropriately narrow and generally familiar to banking entities.[358] The agencies expect that, together, the adopted criteria for the family wealth management vehicle exclusion will prevent a banking entity from being able to bail out such entities 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.

Several commenters requested that the agencies remove the condition that banking entities and their affiliates comply with the disclosure obligations under § __.11(a)(8) of the final rule, as if the vehicle were a covered fund, because such disclosures would not apply to a vehicle

---

[357] *See* 67 FR 76597.

[358] 12 CFR 223.3(ee).

that a banking entity was not organizing and offering pursuant to § __.11(a) of the final rule and therefore would be confusing.[359] In particular, these commenters stated that the required disclosure under § __.11(a)(8) concerning the banking entity's "ownership interests" in the fund and referencing the fund's "offering documents" may create confusion in circumstances where the banking entity does not own an interest in the family wealth management vehicle, or where such vehicles do not have offering documents. Also, commenters requested confirmation from the agencies that banking entities would be permitted to (i) modify the required disclosures to reflect the specific circumstances of their relationship with, and the particular structure of, their family wealth management vehicle clients; and (ii) satisfy the written disclosure requirement by means other than including such disclosures in the governing document(s) of the family wealth management vehicle(s).[360]

The agencies are adopting the condition that banking entities and their affiliates comply with the disclosure obligations under § __.11(a)(8) of the final rule with respect to family wealth management vehicles. However, in a change from the 2020 proposal and in response to the concerns raised by commenters, the condition will explicitly permit banking entities and their affiliates to modify the content of such disclosures to prevent the disclosure from being misleading and also permit banking entities to modify the manner of disclosure to accommodate the specific circumstances of the entity.[361] The obligations under § __.11(a)(8) of the final rule apply in connection with the exemption for organizing and offering covered funds, which would

---

[359] *See, e.g.*, ABA and PNC.

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

[361] In the 2020 proposal, the agencies had indicated that for purposes of the proposed exclusion, a banking entity could satisfy these written disclosure obligations in a number of ways and could modify the specific wording of the disclosures in § __.11(a)(8) to accurately reflect the specific circumstances of the family wealth management vehicle.

typically require the preparation and distribution of offering documents. The agencies, however, understand that many family wealth management vehicles may not have offering documents. The agencies have an interest in providing family wealth management vehicle customers with the substance of the disclosure, rather than a concern with the specific wording of the disclosure or with the document in which the disclosure is provided. Accordingly, the agencies have provided that the content of the disclosure may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the family wealth management vehicle.

For example, § __.11(a)(8) requires disclosure that an investor "should read the fund offering documents before investing in the covered fund." In order to accurately reflect the specific circumstances of a family wealth management vehicle for which there are no offering documents, the modified provision will allow the banking entity to revise this disclosure to reference the appropriate disclosure documents, if any, provided in connection with the vehicle. Similarly, the agencies understand the specific wording of the disclosures in § __.11(a)(8) of the rule may need to be modified to accurately reflect the specific circumstances of the banking entity's relationship with the family wealth management vehicle. For example, a banking entity that holds no ownership interest in the family wealth management vehicle may modify the disclosure required in § __.11(a)(8)(i)(A) to reflect its lack of ownership. Moreover, § __.11(a)(8) requires that the banking entity provide these disclosures, "such as through disclosure in the . . . offering documents." The agencies expect that a banking entity could satisfy these disclosure delivery obligations in a number of ways, such as by including them in the family wealth management vehicle's governing documents, in account opening materials or

in supplementary materials (e.g., a separate disclosure document provided by the banking entity solely for purposes of complying with this exclusion and providing the required disclosures).

4. Customer Facilitation Vehicles

The agencies are adopting an exclusion from the definition of "covered fund" under § __.10(b) of the rule for any issuer that acts as a "customer facilitation vehicle." The customer facilitation vehicle exclusion will, as proposed, 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.[362]

A banking entity may only rely on the exclusion with respect to an issuer provided that: (1) 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;[363] and (2) the banking entity and its affiliates: (i) maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to such transaction, investment strategy, or service; (ii) do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such issuer; (iii) comply with the disclosure obligations under § __.11(a)(8), as if such issuer were a covered fund, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer; (iv) do not acquire or retain, as principal, an ownership interest in the issuer, other than up

---

[362] Final rule § __.10(c)(18)(i).

[363] Notwithstanding this condition, up to an aggregate 0.5 percent of the issuer's outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns. Final rule § __.10(c)(18)(ii)(B).

to an aggregate 0.5 percent of the issuer's outstanding ownership interests for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns; (v) comply with the requirements of §§ __.14(b) and __.15, as if such issuer were a covered fund; and (vi) except for riskless principal transactions as defined in § __.10(d)(11), comply with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity were an affiliate thereof.[364]

The agencies continue to believe that this exclusion will appropriately allow banking entities to structure certain 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 final rule. Most commenters that addressed this exclusion were supportive,[365] stating that it would provide banking entities with greater flexibility to meet client needs and objectives.[366] Some commenters found the exclusion's conditions to be reasonable and sufficient.[367] However, two commenters recommended that the agencies impose additional limitations on the exclusion.[368] One of these commenters argued that the exclusion would permit, and possibly encourage, banking entities to increase their risk exposures through the use of customer facilitation vehicles, and the agencies should minimize such risk exposures and promote risk monitoring and management.[369]

---

[364] Final rule § __.10(c)(18)(ii).

[365] *See, e.g.*, SIFMA; BPI; ABA; Credit Suisse; FSF; Goldman Sachs; and IAA.

[366] *See, e.g.*, SIFMA; BPI; ABA; and Goldman Sachs.

[367] *See, e.g.*, SIFMA; FSF; and SAF.

[368] *See* Better Markets and Data Boiler.

[369] *See* Better Markets.

The agencies continue to believe that these vehicles do not expose banking entities to the types of risks that section 13 of the BHC Act was intended to restrict, and that this exclusion is consistent with section 13(d)(1)(D), which permits banking entities to engage in transactions on behalf of customers, when such 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.[370] This exclusion will 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.[371] As stated in the 2020 proposal, the agencies do not believe that section 13 of the BHC Act 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.[372] Some commenters agreed, stating that customer facilitation

---

[370] 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).

[371] This exclusion does not require that the customer relationship be pre-existing. In other words, the exclusion will 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.

[372] 85 FR 12120.

vehicles would not expose banking entities to the types of risks that section 13 was intended to prohibit or limit, particularly given that such vehicles will be subject to a number of conditions, as discussed below.[373]

The exclusion will, as proposed, require that the vehicle be formed by or at the request of the customer.[374] One commenter suggested that the agencies remove this requirement, arguing that it would inhibit a banking entity's ability to provide customers with services in a timely manner.[375] However, the agencies continue to believe that this requirement is an important component of the exclusion because it helps differentiate customer facilitation vehicles from covered funds that are organized and offered by the banking entity. As stated in the 2020 proposal, the requirement will not preclude a banking entity from marketing its customer facilitation vehicle services or discussing with its customers prior to the formation of such vehicles the potential benefits of structuring such services through a vehicle.[376]

As in the 2020 proposal, the agencies are not specifying the types of transaction, investment strategy or other service that a customer facilitation vehicle may be formed to facilitate.[377] One commenter recommended specifying that the exclusion only allow vehicles to be formed for extensions of intraday credit, and payment, clearing, and settlement services, and

---

[373] *See* SIFMA and ABA.

[374] Final rule § __.10(c)(18)(i).

[375] SIFMA (stating that requiring a banking entity to wait for a customer to request formation would delay the banking entity's ability to provide services to the customer without any corresponding regulatory benefit).

[376] 85 FR 12120.

[377] Final rule § __.10(c)(18)(i).

only for purposes of operational efficiency.[378] Another commenter argued that attempting to specify may prevent banking entities from being able to appropriately respond to a customer's requests.[379] The agencies continue to believe that providing flexibility enhances the utility of this exclusion. Specifically, the agencies note that the purpose of this exclusion is to allow banking entities to provide customer-oriented financial services through vehicles, providing customers with exposure to a transaction, investment strategy, or other service that the banking entity may provide to such customers directly. Limiting the type of transaction, investment strategy, or service for which the customer facilitation vehicle may be formed would interfere with this purpose. Accordingly, the agencies are adopting this requirement as proposed.

Under the final rule, similar to the 2020 proposal, a banking entity will be able to rely on the customer facilitation vehicle exclusion only under certain conditions, as stated above.[380] Commenters supported most of the conditions, stating that the exclusion imposes reasonable conditions that provide safeguards.[381] Commenters also suggested modifications to certain conditions, as discussed below.[382] The agencies are adopting the conditions, largely as proposed. However, the agencies are modifying the conditions that relate to *de minimis* ownership of the vehicle, the requirements of 12 CFR 223.15(a), and the disclosure obligations under § __.11(a)(8), as discussed below.

---

[378] *See* Data Boiler.

[379] *See* SIFMA.

[380] Final rule § __.10(c)(18)(ii).

[381] *See, e.g.*, SIFMA; FSF; and SAF.

[382] *See, e.g.*, SIFMA; BPI; and FSF.

As proposed, the exclusion would have permitted banking entities and their affiliates to acquire or retain, as principal, an ownership interest in the issuer up to 0.5 percent of the issuer's outstanding ownership interests, for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.[383] Similar to their request for family wealth management vehicles, commenters suggested that the agencies specifically allow any party that is unaffiliated with the customer, rather than only the banking entities and their affiliates, to own this *de minimis* interest.[384] For the same reasons as discussed above with respect to family wealth management vehicles, the agencies are modifying the *de minimis* ownership provision such that up to an aggregate 0.5 percent of the issuer's outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.[385]

The agencies are adopting, with modifications, the condition for a banking entity to comply with the requirements of 12 CFR 223.15(a), as if such banking entity were a member bank and the issuer were an affiliate thereof.[386] As discussed above, several commenters recommended that the agencies clarify that the family wealth management vehicle exclusion

---

[383] *See* 2020 proposed rule §__.10(c)(18)(ii)(B)(4).

[384] *See* SIFMA; BPI; and FSF.

[385] Final rule § __.10(c)(18)(ii)(B).

[386] Final rule § __.10(c)(18)(ii)(C)(6). 12 CFR 223.15(a) provides that a member bank may not purchase a low-quality asset from an affiliate unless, pursuant to an independent credit evaluation, the member bank had committed itself to purchase the asset before the time the asset was acquired by the affiliate. 12 CFR 223.15(a).

permits banking entities to engage in riskless principal transactions to purchase assets—including low quality assets for purposes of section 223.15 of the Board's Regulation W—from family wealth management vehicles.[387] One such commenter also suggested that, for purposes of consistency, the agencies should similarly clarify that banking entities are permitted to engage in such riskless principal transactions with customer facilitation vehicles.[388]

The purpose of the proposed requirement that a customer facilitation vehicle must comply with 12 CFR 223.15(a) was the same for both the family wealth management vehicle and the customer facilitation vehicle exclusions—to help ensure that the exclusions do not allow banking entities to "bail out" either vehicle.[389] For the same reasons discussed above with respect to family wealth management vehicles, the agencies have modified the requirement to exclude from the requirements of 12 CFR 223.15(a) transactions that meet the definition of riskless principal transactions as defined in § __.10(d)(11).[390] Similar to the agencies' approach with respect to family wealth management vehicles, the agencies expect that, together, the adopted criteria for this exclusion will prevent a banking entity from being able to bail out customer facilitation vehicles in periods of financial stress or otherwise expose the banking entity to the types of risks that the covered fund provisions of section 13 of the BHC Act were intended to address.

---

[387] *See, e.g.*, BPI and SIFMA. *See supra*, Section IV.C.3 (Family Wealth Management Vehicles).

[388] *See* BPI.

[389] *See* 85 FR 12120.

[390] Final rule § __.10(c)(18)(ii)(C)(6).

The agencies are modifying the condition that the banking entity and its affiliates comply with the disclosure obligations under § __.11(a)(8), as if such issuer were a covered fund, to provide clarification that the content of the disclosure may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer.[391] Commenters requested that the agencies provide such clarification in the context of family wealth management vehicles.[392] Although the agencies did not receive any comments with respect to this condition in the context of this exclusion, the agencies are similarly modifying this condition under this exclusion. The agencies believe that these disclosures will provide important information to the customers for whom these vehicles will be used to provide services – whether they are family customers under the family wealth management vehicle exclusion or other customers under this exclusion. The agencies' treatment of this condition for family wealth management vehicles, as described above, will similarly apply to this condition for customer facilitation vehicles.[393]

The agencies are adopting, as proposed, the condition 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 others, as discussed above).[394] The agencies continue to believe that this condition is appropriate to prevent banking entities from using this exclusion for customer facilitation vehicles to evade the restrictions of section 13 of the BHC Act. To help track compliance, a banking entity and its

---

[391] Final rule § __.10(c)(18)(ii)(C)(3).

[392] *See supra*, Section IV.C.3 (Family Wealth Management Vehicles).

[393] *Id.*

[394] Final rule §§ __.10(c)(18)(ii)(A)–(B).

affiliates will, as proposed, have to maintain documentation outlining how the banking entity intends to facilitate the customer's exposure to a transaction, investment strategy, or service.[395]

The agencies are also adopting, as proposed, the condition that the banking entity and its affiliates do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of such issuer.[396] The agencies continue to believe that this condition is appropriate and consistent with the goal of preventing banking entities from bailing out their customer facilitation vehicles. Commenters generally agreed, supporting the condition as one that is reasonable and appropriate in addressing the agencies' potential evasion concerns.[397]

Finally, the agencies are adopting, as proposed, the condition that the banking entity and its affiliates comply with the requirements of §§ __.14(b) and __.15, as if such issuer were a covered fund.[398] The agencies requested comment in the 2020 proposal whether this exclusion should also require that the banking entity and its affiliates comply with the requirements of all of § __.14. One commenter argued that requiring compliance with the requirements of all of § __.14 would eliminate the utility of this exclusion.[399] The same commenter supported the condition, as proposed, stating that requiring compliance with only § __.14(b), which would apply the requirements in section 23B of the Federal Reserve Act, and the application of the

---

[395] Final rule § __.10(c)(18)(ii)(C)(1).

[396] Final rule § __.10(c)(18)(ii)(C)(2).

[397] *See, e.g.*, SIFMA; FSF; and Data Boiler.

[398] Final rule § __.10(c)(18)(ii)(C)(5).

[399] *See* FSF (stating that if banking entities were required to comply with all of § __.14, they would not be able to enter into swaps and other covered transactions with the customer facilitation vehicle for their clients, many of whom seek such transactions through the use of such vehicles).

prudential backstops under § __.15 would serve as adequate safeguards to avoid the risk of bailout or other evasion concerns.[400] The agencies continue to believe that this condition will help ensure that banking entities and their affiliates' exposure to risk remains appropriately limited.

The agencies continue to believe that, collectively, the conditions on the exclusion will help to ensure that customer facilitation 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 final rule. The agencies also continue to believe that the adopted conditions will be consistent with the purposes of section 13.

As in the 2020 proposal, the agencies will not apply § __.14(a) to customer facilitation vehicles because the agencies understand that this would prohibit banking entities from providing the full range of banking and asset management services to customers using these vehicles. Commenters generally supported this approach,[401] and one noted that applying § __.14(a) to these vehicles would undo any practical utility of the exclusion.[402]

D. Limitations on Relationships with a Covered Fund

In the 2020 proposal, the agencies proposed to amend 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

---

[400] *See* FSF.

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

[402] *See* SIFMA.

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).[403]

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 as if the banking entity was a member bank and the covered fund was an affiliate.[404] The 2020 proposal would have amended the application of section 13(f)(1) of the BHC Act in limited circumstances, by allowing a banking entity to enter into certain 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. In addition, the 2020 proposal would have allowed 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. The agencies invited comment on the past interpretation of section 13(f)(1) of the BHC Act,[405] and the proposed amendments to the regulations implementing section 13(f)(1).[406]

---

[403] *See* 2020 proposal § __.14(a)(2), (3); 85 FR 12143–12146.

[404] 12 U.S.C. 1851(f)(1); *see also* 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.

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

[406] 85 FR 12145-46.

As described in the 2020 proposal, the agencies believe the statutory rulemaking authority under paragraph (d)(1)(J) of section 13 of the BHC Act permits the agencies 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.[407] This interpretation of the agencies' rulemaking authority is supported both by the inclusion of other covered transactions within the permitted activities listed in paragraph (d)(1) of section 13 and by the manner in which section 13(f)(1) of the BHC Act is incorporated in the list of permitted activities in paragraph (d)(1), as described below.

Section 23A of the Federal Reserve Act limits the aggregate amount of covered transactions between a member bank and its affiliates, while 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.[408] Despite the general

---

[407] 12 U.S.C. 1851(b)(2), (d)(1)(J), (d)(2).

[408] 12 U.S.C. 371c, 12 U.S.C. 1851(f)(1). The term "covered transaction" is defined in section 23A of the Federal Reserve Act to mean, with respect to an affiliate of a member bank, (1) a loan or extension of credit to the affiliate, including a purchase of assets subject to an agreement to repurchase; (2) a purchase of or an investment in securities issued by the affiliate; (3) a purchase of assets from the affiliate, except such purchase of real and personal property as may be specifically exempted by the Board by order or regulation; (4) the acceptance of securities or other debt obligations issued by the affiliate as collateral security for a loan or extension of credit to any person or company; (5) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate; (6) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate; or (7) a derivative transaction, as defined in paragraph (3) of section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b)), with an affiliate, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate. *See* 12 U.S.C. 371c(b)(7), as amended by Pub. L. 111.203, section 608 (July 21, 2010). Section 13(f) of the BHC Act does not alter the applicability of section 23A of the Federal Reserve Act and the Board's Regulation W to covered transactions between insured depository institutions and their affiliates.

prohibition on certain covered transactions in section 13(f)(1), section 13 also 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.[409] 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. For example, despite the general prohibition on covered funds, another part of section 13 permits a bank entity "to acquire or retain an ownership interest in a covered fund in accordance with the requirements of section 13."[410] In the preamble to the 2013 rule, the agencies specifically interpreted section 13 to allow such investments noting that a contrary interpretation would make the specific language that permits covered transactions between a banking entity and a related covered fund "mere surplusage."[411] The statute also 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).[412] 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.[413]

---

[409] 12 U.S.C. 1851(d)(1)(G); (d)(4).

[410] 79 FR 5746.

[411] *Id*.

[412] 12 U.S.C. 1851(d)(1)(G)(v).

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

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,[414] the activities permitted pursuant to paragraph (d) specifically contemplate allowing a banking entity to enter into certain covered transactions with related funds.[415] 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).[416] 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 continue to 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.[417]

Several commenters expressed support for the proposed amendments to the regulations implementing section 13(f)(1) of the BHC Act that would have permitted a banking entity to engage in a limited set of covered transactions with a related covered fund.[418] Some commenters recommended that the agencies clarify whether a banking entity may enter into exempt transactions with a related covered fund in the circumstance where such transactions would be

---

[414] *See* 76 FR 68912 n.313.

[415] 12 U.S.C. 1851(d)(1)(G); (d)(4).

[416] 12 U.S.C. 1851(d)(1)(G)(iv).

[417] 12 U.S.C. 1851(b)(2), (d)(1)(J), (d)(2).

[418] *See, e.g.,* ABA; BPI; CBA; Data Boiler; EBF; FSF; IIB; PNC; and SIFMA.

exempt from section 23A of the Federal Reserve Act only if a bank entered into such transactions with a securities affiliate.[419] A few commenters also recommended that the agencies adopt a new exclusion allowing a banking entity to offer other types of extensions of credit to a related covered fund, including extensions of credit in the ordinary course of business.[420] Other commenters recommended that the agencies clarify that section 13(f)(1) does not apply outside of the United States.[421] The commenters noted that such an approach would limit the extraterritorial effect of section 13(f)(1), and would better align section 13(f)(1) with the manner in which section 23A of the Federal Reserve Act applies outside of the United States.

As discussed below, the final rule adopts the proposed amendments from the 2020 proposal with minor modifications. The agencies believe that, under certain circumstances, it is appropriate to permit banking entities to enter into certain covered transactions with related covered funds, in the manner described in the amendments to § __.14 of the implementing regulations. Consistent with the 2020 proposal, these amendments do not modify the definition of "covered transaction" but instead authorize banking entities to engage in limited transactions with related covered funds. Any transactions permitted by these revisions must still meet the eligibility requirements for the particular transaction, and the banking entity must also comply with certain conflict of interest, high-risk, and safety and soundness restrictions with respect to such transactions. The agencies are also expressly providing that a banking entity may enter into certain riskless principal transactions with a related covered fund, as described below.

---

[419] ABA; BPI; FSF; and SIFMA.

[420] BPI and PNC.

[421] CBA; EBF; and IIB.

Exempt Transactions under Section 23A and the Board's Regulation W; Riskless Principal Transactions

The final rule adopts the amendments to the regulations implementing section 13(f)(1) of the BHC Act to permit banking entities to enter into exempt transactions permitted under section 23A and the Board's Regulation W. Specifically, the final rule permits a banking entity to engage in certain 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 certain transactions that would be exempt pursuant to section 223.42 of the Board's Regulation W.[422]

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.[423] Nevertheless, 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, provided such transactions meet the criteria specified in Regulation W.[424]

Under the Board's Regulation W, a member bank may enter into certain exempt covered transactions only with a securities affiliate. Specifically, under these exempt covered

---

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

[423] 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).

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

transactions, a member bank may enter into transactions to purchase marketable securities, to purchase municipal securities, and to enter into riskless principal transactions only with a securities affiliate.[425] In permitting such transactions under Regulation W, the Board previously concluded that the condition that such transactions were permissible only with a securities affiliate was an important consideration that helped justify the exemption, noting that securities affiliates generally must be registered as broker-dealers, and are therefore subject to SEC supervision and examination, and are required to keep detailed records concerning each securities transaction.[426]

The exempt transactions specified in section 23A of the Federal Reserve Act and Regulation W are structured in a manner so as not to present the same concerns about a depository institution suffering losses or transferring the subsidy arising from the depository institution's access to the Federal safety net. The agencies believe that the same rationale that supports the exemptions in section 23A of the Federal Reserve Act and the Board's Regulation W also supports 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, provided that such transactions are subject to the same requirements and conditions specified in Regulation W. In particular, the agencies note that these exemptions generally do not present significant risks of loss and serve important public policy objectives.[427]

---

[425] 12 CFR 223.42(f), (g), (m).

[426] 67 FR 76591 (December 12, 2002); *see* 67 FR 76593, 76597.

[427] 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

Several commenters recommended that the agencies clarify whether a banking entity may enter into certain transactions with a related covered fund that would be permissible under the Board's Regulation W if entered into between a bank and a securities affiliate, even if the covered fund would not meet the eligibility criteria to be a "securities affiliate" under the Board's Regulation W.[428] As noted above, Regulation W imposes various conditions and requirements on transactions that a bank enters into with its affiliates, and permits a bank to enter into transactions involving the purchase of marketable securities, the purchase of municipal securities, and riskless principal transactions only with an affiliate that is a "securities affiliate" as defined in Regulation W. With respect to purchases of marketable securities and municipal securities, the final rule follows the approach adopted in Regulation W, and permits a banking entity to enter into such covered transactions with a related covered fund only if those transactions would meet all of the eligibility criteria to qualify as exempt transactions under Regulation W, including the requirement that the related covered fund meets the requirements to be a securities affiliate.[429] As noted above, the exempt transactions specified in Regulation W include various limits and conditions that both limit the risks of such transactions and allow the Federal banking agencies to monitor compliance. Generally, the final rule retains the eligibility

---

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.

[428] ABA; BPI; FSF; and SIFMA. Under the Board's Regulation W, a "securities affiliate" is defined as "[a]n affiliate of the member bank that is registered with the Securities and Exchange Commission as a broker or dealer; or… [a]ny other securities broker or dealer affiliate of a member bank that is approved by the Board." 12 CFR 223.3(gg).

[429] In addition to requiring that an affiliate be a securities affiliate, the exemptions under Regulation W permitting a bank to purchase marketable securities or municipal securities in certain circumstances require the bank to retain records about the underlying transaction. *See* 12 CFR 223.42(f)(6), (g)(3)(iii)(B).

criteria for exempt covered transactions defined in Regulation W. The agencies believe that these conditions serve important policies, and appropriately limit the scope of the exempt transactions permissible under the implementing regulations.

The final rule permits banking entities to enter into riskless principal transactions with a related covered fund, including in circumstances where the covered fund is not a "securities affiliate."[430] In a riskless principal transaction, the riskless principal (the banking entity) buys and sells the same security contemporaneously, and the asset risk passes promptly from the affiliate (the related covered fund) through the riskless principal to a third party.[431] In permitting such transactions under Regulation W, the Board previously found that there was no regulatory benefit to subjecting riskless principal transactions to section 23A of the Federal Reserve Act, because such transactions closely resemble securities brokerage transactions, and these transactions do not allow the affiliate to transfer risk to the affiliate acting as a riskless principal.[432]

Although the 2020 proposal would have permitted a banking entity to enter into a riskless principal transaction with a covered fund provided it met the criteria in Regulation W, the final rule adopts a standalone exception to differentiate riskless principal transactions specifically from other transactions that would be exempt transactions under the Board's Regulation W.[433] In connection with permitting banking entities to enter into riskless principal transactions with related covered funds in a separate exception from Super 23A, the agencies are defining riskless

---

[430] *Cf.* 12 CFR 223.42(m).

[431] *See* 67 FR 76597.

[432] *Id*.

[433] 12 CFR 223.42.

principal transactions in § __.10 of the regulations. The definition of riskless principal transactions adopted in the final rule is similar to the definition adopted in the Board's Regulation W, as this definition is appropriately narrow and generally familiar to banking entities.[434]

In addition, and as discussed in more detail below, banking entities may separately rely on the independent exception for acquisitions of assets in connection with payment, clearing, and settlement services. The agencies expect that in many instances, subject to other applicable laws and regulations, a banking entity may be able to engage in acquisitions of assets in connection with payment, clearing, and settlement services, without relying on the exception permitting banking entities to enter into covered transactions with their related covered funds that would be exempt under Regulation W.

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

The final rule adopts the proposed amendments in the 2020 proposal that would have permitted a banking entity to provide short-term extensions of credit to, and purchase assets from, a related covered fund, subject to appropriate limits. Under the final rule, each short-term extension of credit or purchase of assets must be made in the ordinary course of business in connection with payment transactions; securities, derivatives, or futures clearing; or settlement services. In addition, each extension of credit must be required to be repaid, sold, or terminated no later than five business days after it was originated. Additionally, the proposed five business day criterion is consistent with the Federal banking agencies' capital rules and would generally

[434] *See* 12 CFR 223.3(ee).

limit banking entities to transactions with normal settlement periods, which have lower risk of delayed settlement or failure, when providing short-term extensions of credit.[435] 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). Under these requirements, the banking entity making a short-term extension would have to meet the same requirements as it would to engage in an intraday extension of credit under Regulation W (and as incorporated in the implementing regulations). Specifically, the banking entity would need to have policies and procedures to manage the credit exposure and must have no reason to believe that the related covered fund will have difficulty repaying the extension of credit in accordance with its terms. Finally, each extension of credit or purchase of assets permitted by these revisions must also comply with certain conflict of interest, high-risk, and safety and soundness restrictions, and must otherwise be permissible for the banking entity to enter into with the fund.[436]

---

[435] *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 final rule is consistent with the approach taken in the Federal banking agencies' capital rule, without imposing an additional compliance burden without a corresponding benefit. *See, e.g.*, 12 CFR 3.2; 217.2; 324.2 (defining derivative contract to include unsettled securities with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days); 12 CFR 3.38(d); 217.38(d); 324.38(d) (noting that an institution must hold risk-based capital against any delivery-versus-payment or payment-versus-payment transaction with a normal settlement period if the counterparty has not made delivery within five business days after settlement).

[436] For example, an investment fund with respect to which a member bank or its affiliate is an investment adviser may be subject to additional restrictions under Section 23A of the Federal Reserve Act. *See* 12 U.S.C. 371c(b)(1)(D).

The agencies do not believe it would be appropriate to permit banking entities to enter into other covered transactions with a related covered fund, outside of the exceptions noted above. Although some commenters recommended expanding this exception to allow banking entities to enter into limited amounts of covered transactions with related covered funds, the agencies believe that permitting banking entities to engage in other covered transactions with related covered funds would potentially raise the concerns that paragraph 13(f)(1) was intended to address.

The agencies also do not believe that it would be appropriate to limit the application of section 13(f)(1) to the United States as some commenters recommended, at this time. The agencies note that other amendments in the final rule (for example, amendments to the treatment of foreign excluded funds and foreign public funds) may help address some of the commenters' concerns about the extraterritorial application of section 13(f)(1).

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

The agencies expect that the amendments in the final rule described above would generally promote and protect the safety and soundness of banking entities and U.S. financial stability. In comments previously submitted to the agencies, banking entities that sponsor or serve as the investment adviser to covered funds 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. The commenters said 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.[437] For example, when a banking entity sponsors or advises a 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.

As discussed below, the agencies believe that the exceptions in the final rule would generally promote and protect the safety and soundness of banking entities and U.S. financial stability by allowing 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, even when the banking entity sponsor of the fund typically provides those services to other funds it sponsors. This is the case even when the third party may not offer the same quality of services available through an affiliate, or where the third party may charge more for the same services that could be provided by an affiliate. 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 final rule allows a banking entity to reduce both operational risk and interconnectedness to other financial institutions by directly providing a broader array of

[437] *See* 85 FR 12144.

services to a fund it organizes and offers, or advises. The agencies believe that reducing these risks will promote and protect the safety and soundness of banking entities.[438]

The final rule also would promote and protect U.S. financial stability by reducing interconnectedness among firms. The provision of custodial services among depository institutions in the United States is highly concentrated, with the four largest providers, all of which remain subject to the Volcker Rule, holding more than 85 percent of custodial assets. Requiring a banking entity that organizes and offers a covered fund to use a third party to provide these services could increase the interconnections between these firms and the risk that distress at one banking entity would be spread to the others. The authorized covered transactions would permit banking entities to provide a more comprehensive suite of services to related covered funds, reducing interconnectedness by reducing the need to rely on third parties to provide such services.

The final rule also retains important limits on the transactions that a banking entity may enter into with a related covered fund, including limitations that apply to transactions within the new exceptions in the regulations implementing § __.14(a). As specified in the statute, such activities are 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…"[439] Section

---

[438] The agencies believe that the same rationales that supported exempting certain 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 those exempt covered transactions with a related covered fund, subject to the same terms and conditions as applicable under section 23A and Regulation W.

[439] 12 U.S.C. 1851(d)(1).

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).[440]

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) as 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.[441]

The agencies therefore have determined that the amendments to § __.14(a) of the final rule, in the manner described above, would promote and protect both the safety and soundness of banking entities, and U.S. financial stability.

E. Ownership Interest

1. Definition of "ownership interest"

The 2013 rule defines 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

[440] 12 U.S.C. 1851(d)(2); *see also* 2013 rule §§ __.7 and __.15.

[441] 12 U.S.C. 1851(f)(2); *see* 12 U.S.C. 371c–1(a)(1).

standard covenants within the definition of 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.[442]

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 certain 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).

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.[443] Among other things, the agencies requested comments on whether they should modify § __.10(d)(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.[444]

---

[442] 2013 rule § __.10(d)(6)(i).

[443] 83 FR 33481.

[444] *Id.*

A number of comments received on the 2018 proposal supported the agencies' suggestion to modify § __.10(d)(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.[445] However, a few of these commenters on the 2018 proposal 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 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.[446] 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 on the 2018 proposal 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.[447] 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.[448] One other commenter asked the agencies to clarify conditions under the "other similar interest" clause.[449] Specifically, the commenter asked the agencies to clarify whether the right to

---

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

[446] *See* SFIG.

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

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

[449] *See* SFIG.

receive all or a portion of the spread extends to using the excess spread or any debt repaid from collections on underlying assets of a special purpose entity to pay principal or interest that is otherwise owed is not an ownership interest. Another 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.[450]

In response to comments received on the 2018 proposal 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 2020 proposal would have amended the parenthetical in § __.10(d)(6)(i)(A) to specify that creditors' remedies upon the occurrence of an event of default or an acceleration event, which include, for example, 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 occurrence of an event of default, would not be considered an ownership interest for this reason alone.[451] The 2020 proposal also sought comment on whether it would be appropriate to further allow for an interest to confer 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, without that interest being deemed an ownership interest. Such additional "for cause" termination events may include 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.

---

[450] *See* Data Boiler.

[451] The definition of "ownership interest" in the implementing regulations is independent from the definition of "voting securities" in the Board's Regulation Y.

Commenters on the 2020 proposal generally supported the proposed amendment to the definition of ownership interest 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 occurrence of an event of default. In the view of these commenters, the proposed clarification would appropriately recognize that the ability of a holder to vote on removal or appointment of managers for cause is not a right limited to equity holders. However, many of these commenters asserted that creditors' rights are also provided to debt holders in circumstances other than an event of default or acceleration. These commenters therefore recommended the proposed amendments be expanded to include additional for cause events that are independent of an event of default or acceleration, such as the insolvency of the investment manager or breach of the investment management or collateral management agreement.[452]

In light of comments received on the 2020 proposal, the agencies recognize that it is customary for debt holders to hold certain rights to participate in the removal or replacement of an investment manager for cause that may be triggered by events other than default or acceleration events. The agencies believe that debt interests that include the rights of a creditor to participate in the for-cause removal or replacement of an investment manager under certain circumstances do not necessarily constitute the type of interest Section 13 of the BHC Act is intended to capture as an ownership interest. The agencies are therefore finalizing, with certain modifications, the amendments to § __.10(d)(6)(i)(A) in order to provide clarity about the types of creditor rights that may attach to an interest without that interest being deemed an ownership interest. The agencies have modified the scope of the definition of ownership interest in the final

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

rule to allow for certain additional rights of creditors that are not triggered exclusively by an event of default or acceleration to attach to a debt interest without such interests being deemed ownership interests. In addition to such rights arising under events of default or acceleration, under the final rule, the definition of ownership interest does not include rights of a creditor to participate in the removal or replacement of an investment manager for cause in connection with:

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

fund or to the investment manager's exercise of investment discretion under the covered fund's transaction agreements.

The 2020 proposal also would have provided a safe harbor from the definition of ownership interest, as suggested by some commenters to the 2018 proposal.[453] The safe harbor was intended to address concerns of commenters to the 2018 proposal that some ordinary debt interests could be construed as an ownership interest. The 2020 proposal, therefore, would have provided that any senior loan or other senior debt interest that meets all of the following characteristics would not be considered to be an ownership interest:

(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 (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 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).

[453] *See* SFIG.

Commenters on the 2020 proposal generally supported the proposed safe harbor from the definition of ownership interest for certain senior loans or senior debt interests that do not have equity-like characteristics.[454] However, certain commenters also requested that the agencies clarify that the safe harbor is available to senior loans and senior debt interests where repayment of principal may vary as a result of acceleration or amortization provisions.[455] Additionally, certain commenters also requested that the agencies clarify that the reference to senior loans or senior debt interests in the proposed safe harbor includes all exposures that would meet the definition of "investment grade" found in 12 CFR part 1 and implementing guidelines, as long as such exposures comply with the proposed conditions.[456]

The agencies intended for the proposed conditions of the safe harbor to provide clarity and predictability to banking entities by enabling them to determine more readily whether an interest would be an ownership interest under the regulations implementing section 13 of the BHC Act. After considering comments received, the agencies have included the conditions from the 2020 proposal for the safe harbor with a modification to § __.10(d)(6)(ii)(B)(*1*)(*ii*). The modification requires that the senior loan or senior debt interest involves, among other things, repayment of a fixed principal amount, on or before a maturity date, in a contractually-determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment). The agencies believe this modification will provide additional clarity that the safe harbor is available to senior loan and senior debt interests where contractual principal payments vary over the life of

---

[454] *See, e.g.*, SIFMA; BPI; LSTA; Mortgage Bankers Association; and PNC.

[455] *See* SIFMA.

[456] *See, e.g.*, LSTA and SFA.

a senior loan or senior debt interest for reasons such as amortization and acceleration provided that the total amount of principal required to be repaid over the life of the instrument does not change. The agencies believe this modification to the safe harbor under the final rule will ensure that debt interests that do not have equity-like characteristics are not considered ownership interests. Additionally, 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.

Further, in response to certain commenters' request that the agencies clarify that the reference to senior loans or senior debt interests in the proposed safe harbor includes all exposures that would meet the definition of "investment grade" found in 12 CFR part 1 and implementing guidelines, the agencies have determined that such a provision would be inappropriate for purposes of the safe harbor conditions in the final rule. Unlike the safe harbor provisions in the final rule regarding ownership interests, such a provision would not ensure that debt interests that have equity-like characteristics are treated as ownership interests for purposes of subpart C of the final rule.

In response to the 2020 proposal, one commenter requested that the agencies modify the condition in § __.10(d)(6)(i)(B) of the implementing regulations and § __.10(d)(6)(ii)(B)(1) of the 2020 proposal, which states that 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, to clarify that the condition would not include amounts payable to securitization noteholders in accordance with a contractual priority of payments, commonly referred to as a "waterfall," so long as such amounts are limited to fixed principal and interest determined on a fixed or typical index floating rate

basis.[457] Specifically, the commenter suggested a modification to this condition to clarify that the term "profit" is intended to mean "net profits" out of concern for the potential ambiguity of how the condition would apply to amounts received by securitization noteholders in accordance with the securitization's waterfall of payment. Another commenter disagreed with any revision to the 2020 proposed rule that would only cover as an ownership interest an interest which has the right to receive a share of the "net" income, gains or profits of the covered fund.[458] The final rule does not modify § __.10(d)(6)(i)(B) of the implementing regulations or § __.10(d)(6)(ii)(B)(1) of the 2020 proposal. However, the agencies clarify that a debt interest in a covered fund would not be considered an ownership interest solely because the interest is entitled to receive an allocation of collections from the covered fund's underlying financial assets in accordance with a contractual priority of payments.

2. Fund Limits and Covered Fund Deduction

The 2020 proposal included amendments to 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 2020 proposal would have modified §§ __.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.

---

[457] *See* SFA.

[458] *See* Data Boiler.

The 2013 rule excludes from the definition of ownership interest certain restricted profit interests.[459] 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.[460]

Under § __.12 of the 2013 rule, different calculation methodologies apply for purposes of calculating compliance with the per fund limit, the aggregate fund limit, and the covered fund deduction.[461] 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. [462]

The agencies did not receive comments on the proposed change in the treatment of restricted profit interests. Several commenters recommended that the agencies eliminate the per

---

[459] 2013 rule § __.10(d)(6)(ii). Under the 2013 rule, 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. 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.

[460] 2013 rule § __.10(d)(6)(ii)(C).

[461] 2013 rule § __.12(b)(1)(iv). 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 directly or indirectly, is counted against the per fund limit and aggregate fund limit. *See* 79 FR 5733.

[462] 2013 rule § __.10(d)(6)(C); §§ __.12(c)(1), (d). *See also* 12 U.S.C. 1851(d)(1)(G).

fund limit, the aggregate fund limit, and the covered fund deduction with respect to any ownership interest held by a banking entity in any covered fund, if that interest is held pursuant to underwriting and market making activities.[463]

With respect to the proposed change in the treatment of restricted profit interests, 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 covered fund 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's or director's acquisition of a restricted profit interest in a covered fund organized or offered by the banking entity. The final rule amends the implementing regulations to limit the attribution of an employee's or director's restricted profit interest in a covered fund organized or offered by the banking entity to only those circumstances in which the banking entity has directly or indirectly financed the acquisition of the restricted profit interest. The agencies expect that this amendment will 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).

The final rule does not adopt the recommendation from commenters that the agencies should eliminate the per fund limit, aggregate fund limit, or covered fund deduction

[463] BPI; FSF; IIB; and SIFMA.

requirements. The 2019 amendments adopted several changes to simplify the covered fund compliance requirements for banking entities that engage in market making or underwriting with respect to a third-party covered fund. Specifically, the 2019 amendments eliminated the aggregate fund limit and capital deduction requirements for the value of ownership interests in third-party funds acquired or retained in connection with permissible market making or underwriting activities (i.e., covered funds that the banking entity does not advise or organize and offer pursuant to § __.11(a) or (b) of the implementing regulations). In discussing this change in the preamble to the 2019 amendments, the agencies noted that the amendments to the treatment of ownership interests in third-party funds were intended to better align the compliance requirements for underwriting and market making involving covered funds with the risks that those activities entail.[464] The compliance challenges associated with underwriting and market making in ownership interests in covered funds is particularly acute with respect to third-party covered funds. As discussed in the preamble to the 2019 amendments, "a banking entity can more readily determine whether a fund is a covered fund if the banking entity advises or organizes and offers the fund." [465] While section 13 of the BHC Act provides the agencies greater flexibility to adopt changes in the treatment of ownership interests in third-party funds, it prescribes specific requirements that apply to funds that the banking entity advises, or organizes and offers. Specifically, section 13 provides that a banking entity must not acquire or retain an ownership interest in a fund organized and offered by the banking entity except for a *de minimis* investment subject to and in compliance with paragraph (d)(4) of section 13 of the BHC Act.[466]

---

[464] *See* 84 FR 62017.

[465] *Id.*

[466] 12 U.S.C. 1851(d)(1)(G)(iii).

Therefore, the final rule does not adopt the change recommended by commenters to modify the treatment of ownership interests in related covered funds that are held by a banking entity in connection with market making and underwriting activities.

F. Parallel Investments

The 2020 proposal included a new rule of construction in § __.12(b) clarifying that banking entities are not required to treat investments alongside covered funds as investments in covered funds if certain conditions are met.[467] As explained in the 2020 proposal, this rule of construction was meant to provide clarity in light of a discrepancy between the preamble to the 2013 rule and the text of the implementing regulations.

The implementing regulations require 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.[468] Section __.12(b)(1)(i) of the implementing regulations 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."[469] 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 of certain direct investments by a banking entity alongside, or otherwise in

---

[467] *See* 85 FR 12149.

[468] *See id.* at 12148; implementing regulations § __.12.

[469] *See* implementing regulations § __.12(b)(1)(i).

parallel with, a covered fund.[470] The agencies declined to adopt this provision in the 2013 rule after considering the language of the statute as well as commenters' views on that provision.[471]

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. 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.[472] Neither section 13(d)(4) of the BHC Act nor the text of the implementing regulations requires a banking entity to 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.[473] However, in the preamble to the 2013 rule, the agencies discussed the potential for evasion of the per fund limit and aggregate fund limit 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."[474] The agencies also stated that "a banking entity that sponsors the covered fund should not itself make

---

[470] 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).

[471] In declining 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. 79 FR 5734.

[472] 12 U.S.C. 1851(d)(4).

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

[474] 79 FR 5734.

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."[475]

The 2020 proposal included a new rule of construction to address investments made by banking entities alongside covered funds. This proposed rule of construction was intended to clarify in the rule text that banking entities are not required to treat a direct investment by a banking entity alongside a covered fund as an investment in the covered fund if certain conditions are met. Specifically, proposed § __.12(b)(5) provided that:

(1) 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.

(2) 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.[476]

In the preamble to the 2020 proposal, the agencies recognized that banking entities rely on a number of investment authorities and structures to make investments and meet the needs of their clients and shareholders.[477] The agencies indicated that the proposed rule of construction would provide clarity to banking entities so that they may make such investments for the benefit

---

[475] *See id.*

[476] *See* 85 FR 12149.

[477] *Id. See also* 79 FR 5734.

of their clients and shareholders, provided that those investments comply with applicable laws and regulations.[478] The preamble to the 2020 proposal went on to note several restrictions that may apply to a banking entity's investment alongside a covered fund. For example, a banking entity may not engage in prohibited proprietary trading alongside a covered fund. Likewise, a banking entity must have authority to make any investment alongside a covered fund under applicable banking and other laws and regulations and must 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. In addition, a banking entity that invests alongside a covered fund that the banking entity organizes and offers under the asset management exemption in § __.11 would need to comply with all the conditions of that exemption, which, among other things, prohibits the banking entity from guaranteeing, assuming, or otherwise insuring the obligations or performance of the covered fund. Thus, a 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. Likewise, the banking entity would also need to ensure that any 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.[479]

---

[478] 85 FR 12149.

[479] *See id.* 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 investments. *Id.*

Most commenters that addressed the proposed rule of construction supported adopting the proposed revision.[480] Commenters stated that the rule of construction was consistent with section 13 of the BHC Act, would not increase the types of risks that section 13 of the BHC Act was meant to address, and would not raise concerns about evading section 13 of the BHC Act.[481] Commenters noted that banking entities would need to hold their investments in a manner consistent with relevant authorities and the associated risk management and other prudential and regulatory limits and controls, including stringent capital requirements, for these types of investments.[482] Some commenters also requested that the agencies permit employees and directors of a banking entity that sponsors a covered fund to invest directly in that covered fund, regardless of whether the employees or directors provide services to the covered fund on behalf of their banking entity employer.[483] The agencies received one comment opposing the proposed rule of construction.[484] This commenter characterized the proposed rule of construction as permitting proprietary trading at arm's length but without a limit on the ownership interest that a banking entity may hold and stated that parallel investments should be subject to the limitations that would apply to direct investments in covered funds.[485]

After carefully considering the comments received, the agencies are adopting the rule of construction in § __.12(b)(5), as proposed.[486] As described above and in the 2020 proposal, this

---

[480] *See* FSF; SIFMA; BPI; IIB; Goldman Sachs; PNC; and ABA.

[481] *See* FSF; SIFMA; and BPI.

[482] *See* FSF; SIFMA; and BPI.

[483] *See* ABA and PNC

[484] *See* Data Boiler.

[485] *See id.*

[486] Final 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

rule of construction is consistent with the text of section 13 of the BHC Act, which does not prohibit a banking entity from making otherwise permissible investments directly when doing so alongside a covered fund. This rule of construction will also reduce compliance burden by clarifying that a banking entity is not required under § __.12 of the final rule to attribute to the banking entity direct investments made alongside a covered fund for purposes of the *de minimis* investment limitation. In response to the commenter who opposed the rule of construction,[487] the agencies note that the rule of construction is consistent with section 13 of the BHC Act and each investment by a banking entity must comply with laws and regulations, including any applicable safety and soundness standards.

As discussed in the preamble to the 2020 proposal, the rule of construction will 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. However, as discussed in the preamble to the 2020 proposal, the agencies would expect that any such investment policies, arrangements or agreements would ensure that the

---

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.

[487] *See* Data Boiler.

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.

As discussed earlier and in the preamble to the 2020 proposal, 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 continue to believe that such a prohibition is not 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.

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 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.

As discussed in the preamble to the 2020 proposal, 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' 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.[488] 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.[489]

---

[488] *See* 2013 rule § __.12(b)(1)(iv) (requiring attribution of an investment by a director or employee *in a covered fund* organized and offered by the banking entity, 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) (emphasis added).

[489] *See* 2013 rule § __.11(a)(7) (prohibiting investments by any director or employee of the banking entity (or an affiliate thereof) *in a covered fund* organized and offered by the banking entity, other than any director or employee who is directly engaged in providing investment

With respect to investments in a covered fund, the agencies decline to permit an employee or director of a banking entity that organizes and offers a covered fund to make investments in that covered fund if the director or employee does not provide services to the covered fund on behalf of the banking entity, as requested by some commenters.[490] The restriction on these types of director and employee investments is required by the statute.[491]

G. Technical Amendments

The agencies proposed five sets of clarifying technical edits to the implementing regulations. Specifically, the agencies proposed 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."

The agencies did not receive comment on these provisions and are adopting the technical amendments as proposed.

---

advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee makes the investment) (emphasis added).

[490] *See* ABA and PNC.

[491] *See* 12 U.S.C. 1851(d)(1)(G)(vii).

V. Administrative Law Matters

A. Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act[492] requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Federal banking agencies sought to present the proposed rule in a simple and straightforward manner and did not receive any comments on plain language.

B. Paperwork Reduction Act

Certain provisions of the final 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 final rule and determined that the final rule creates new recordkeeping requirements and revises certain disclosure requirements that have been previously cleared under various OMB control numbers. The agencies did not receive any specific comments on the PRA. The agencies are extending for three years, with revision, these information collections. The information collection requirements contained in this final rule 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 final rule under the authority delegated to the Board by OMB. The Board will submit information collection burden estimates to OMB, and the submission will include burden for Federal Reserve-supervised institutions, as well as burden for OCC-, FDIC-, SEC-, and CFTC-supervised

[492] Pub. L. 106-102, section 722, 113 Stat. 1338, 1471 (1999).

institutions under a holding company. The OCC and the FDIC will take burden for banking entities that are not under a holding company.

Abstract

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, subject to certain exemptions. The exemptions allow certain types of permissible trading and asset management activities.

Current Actions

The final rule contains requirements subject to the PRA, and the changes relative to the implementing regulations are discussed herein. The new recordkeeping requirements are found in section _.10(c)(18)(ii)(C)(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)(C)(1) requires a banking entity relying on the 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 will 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, is being expanded to also apply to banking entities relying on exclusions for credit funds, venture capital funds, family wealth management vehicles, or customer facilitation vehicles. The agencies estimate that the current average hours per response of 0.1 will increase to 0.5.

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)(C)(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.

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.

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.

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. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA)[493] requires an agency to either provide a regulatory flexibility analysis with a final rule or certify that the final 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

[493] 5 U.S.C. 601 *et seq.*

for purposes of the RFA.[494] Except as otherwise specified below, the size standard to be considered a small business for banking entities subject to the final rule is $600 million or less in consolidated assets.[495]

Board

The Board has considered the potential impact of the final 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 certifies that the final rule will not have a significant economic impact on a substantial of number of small entities.

The Board invited comment on all aspects of its analysis related to the requirements of the RFA in connection with the 2020 proposal. In particular, the Board requested that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact. The Board did not receive any comments related to this issue.

As discussed in the **Supplementary Information**, the agencies are adopting 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.[496] Certain of the exclusions from the covered fund definition included in the final rule contain recordkeeping and disclosure requirements that would apply to banking entities relying on the

---

[494] 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.

[495] *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).

[496] 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).

exclusion. For example, the exclusion for customer facilitation vehicles requires 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 final rule is expected to reduce regulatory burden on banking entities, and the Board does not expect these 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),[497] 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.[498] 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 final rule is not expected to have a significant economic impact on a substantial number of small entities.

OCC

[497] Pub. L. 115–174 (May 24, 2018).

[498] 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 five percent or less of total consolidated assets.

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601 et seq., requires an agency, in connection with a final rule, to prepare a Final Regulatory Flexibility Analysis describing the impact of the rule on small entities (defined by the Small Business Administration (SBA) for purposes of the RFA to include commercial banks and savings institutions with total assets of $600 million or less and trust companies with total assets of $41.5 million or less) or to certify that the final rule would not have a significant economic impact on a substantial number of small entities. The OCC currently supervises approximately 745 small entities.[499] Under the EGRRCPA, 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 five percent of their total consolidated assets. In addition, section 13 of the BHC Act generally excludes certain institutions that function only in a trust or fiduciary capacity from the definition of "banking entity. As a result, no OCC-supervised small entities are subject to section 13 of the BHC Act. Thus, the final rule will not impact any OCC-supervised small entities. Therefore, the OCC certifies that the final rule will not have a significant impact on a substantial number of OCC-supervised small entities.

FDIC

The RFA generally requires that, in connection with a final rulemaking, an agency prepare and make available for public comment a final regulatory flexibility analysis describing

[499] The OCC bases its estimate of the number of small entities on 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), the OCC counts the assets of affiliated financial institutions when determining if the OCC should classify an OCC-supervised institution as a small entity. The OCC uses December 31, 2019, 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 SBA's Table of Size Standards.

the impact of the final rule on small entities.[500] However, a regulatory flexibility analysis is not required if the agency certifies that the final 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.[501] Generally, the FDIC considers a significant effect to be a quantified effect in excess of five percent of total annual salaries and benefits per institution, or 2.5 percent of total noninterest 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 final rule will not have a significant economic impact on a substantial number of small entities.

As of December 31, 2019, the FDIC supervised 3,344 depository institutions,[502] of which 2,581 were considered small entities for the purposes of RFA.[503] The Economic Growth, Regulatory Relief, and Consumer Protection Act excluded entities from the requirements of section 13 of the BHC Act that do not have and are not controlled by a company that has total assets of more than $10 billion or trading assets and liabilities comprising more than five percent

---

[500] 5 U.S.C. 601 *et seq*.

[501] 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.

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

[503] FDIC Call Report data, December 31, 2019.

of total consolidated assets.[504] Only one small, FDIC-supervised institution is subject to section 13 of the BHC Act, because its trading assets and liabilities exceed five percent of total consolidated assets.[505]

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 final rule modifies existing definitions and exclusions and introduces new exclusions to the implementing regulations. The final rule permits 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 final rule excludes certain types of investment funds 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 final rule could be reported as deductions from capital on Call Report schedule RC-R 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.[506] The one affected small, FDIC-supervised institution did not report any such deductions over the past five years.[507]

---

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

[505] FDIC Call Report data, December 2019.

[506] *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.

[507] FDIC Call Report data, March 2015–December 2019.

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

SEC

In the 2020 proposal, the SEC certified that, pursuant to 5 U.S.C. section 605(b), the 2020 proposal would not, if adopted, have a significant economic impact on a substantial number of small entities. Although the SEC solicited written comments regarding this certification, no commenters responded to this request.

As discussed in the Supplementary Information, the amendments clarify and simplify compliance with the implementing regulations, refine the extraterritorial application of the section 13 of the BHC Act, and permit additional fund activities that do not present the risks that section 13 was intended to address.

The amendments will 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 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 certifies that the amendments will not have a significant economic impact on a substantial number of small entities.

CFTC

Pursuant to 5 U.S.C. 605(b), the CFTC hereby certifies that the final rule will not 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 final rule clarifies and simplifies compliance with the implementing regulations, refines the extraterritorial application of section 13 of the BHC Act, and permits additional fund activities that do not present the risks that section 13 was intended to address. To reduce the extraterritorial impact of the implementing regulations, the final rule exempts the activities of certain funds that are organized outside of the United States and offered to foreign investors from certain restrictions of the implementing regulations. The final rule also revises several existing exclusions from the covered fund provisions, to provide clarity and simplify compliance with the requirements of the implementing regulations. The final rule adopts several new exclusions from the covered fund definition in order to more closely align the regulation with the purpose of the statute. Last, the final rule adopts revisions to the provisions that govern the relationship between a banking entity and a fund and the definition of ownership interest.

The final rule will 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.[508] The CFTC has previously determined that swap dealers, futures commission merchants and

[508] The final rule 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 final rule. *See* 79 FR 5808, 5813 (Jan. 31, 2014) (CFTC version of 2013 final rule).

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.[509] 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.[510]

In the context of the final rule, 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 final rule applies to only those commodity trading advisors that are affiliated with banks, which the CFTC expects are larger businesses.

The CFTC requested that commenters address in particular whether any of these commodity trading advisors, or other CFTC registrants covered by the proposed revisions, are small entities for purposes of the RFA. The CFTC did not receive any public comments on this or any other aspect of the RFA as it relates to the rule.

Because the CFTC believes that there are not a substantial number of registered, banking entity-affiliated commodity trading advisors that are small entities for purposes of the RFA, and the other CFTC registrants that may be affected by the proposed revisions have been determined not to be small entities, the CFTC believes that the final rule will not have a significant economic

---

[509] *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).

[510] *See* Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18620 (Apr. 30, 1982).

impact on a substantial number of small entities for which the CFTC is the primary financial regulatory agency.

D. Riegle Community Development and Regulatory Improvement Act

Section 302(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA)[511] requires that each Federal banking agency, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. The agencies have considered comment on these matters in other parts of this **Supplementary Information**.

In addition, under section 302(b) of the RCDRIA, new regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally must 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.[512] Therefore, the effective date for the Federal banking agencies is October 1, 2020, the first day of the calendar quarter.[513]

E. OCC Unfunded Mandates Reform Act

The OCC has analyzed the final rule under the factors in the Unfunded Mandates Reform Act of 1995 (UMRA). Under this analysis, the OCC considered whether the final rule includes a

---

[511] 12 U.S.C. 4802(a).

[512] 12 U.S.C. 4802(b).

[513] Additionally, the Administrative Procedure Act generally requires that the effective date of a rule be no less than 30 days after publication in the *Federal Register*. 5 U.S.C. 553(d)(1). The effective date, October 1, 2020, will be more than 30 days after publication in the *Federal Register*.

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

F. SEC Economic Analysis

[Placeholder for SEC Economic Analysis.]

G. Congressional Review Act

[Placeholder for major rule determination.]

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

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 amends 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, 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);

    g. Revising paragraph (d)(6); and

    h. Adding paragraph (d)(11).

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 more than 75 percent of the ownership interests in the issuer are sold 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 § 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;

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

(E) Debt securities, other than asset-backed securities and convertible securities, provided that:

(*1*) the aggregate value of such debt securities does not exceed five percent of the aggregate value of loans held under paragraph (c)(8)(i)(A) of this section, cash and cash equivalents held under paragraph (c)(8)(iii)(A), and debt securities held under this paragraph (c)(8)(i)(E); and

(*2*) the aggregate value of the loans, cash and cash equivalents, and debt securities for purposes of this paragraph is calculated at par value at the most recent time any such debt security is

acquired, except that the issuing entity may instead determine the value of any such loan, cash equivalent, or debt security based on its fair market value if:

(*i*) the issuing entity is required to use the fair market value of such assets for purposes of calculating compliance with concentration limitations or other similar calculations under its transaction agreements, and

(*ii*) the issuing entity's valuation methodology values similarly situated assets consistently.

(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, other than debt securities permitted under paragraph (c)(8)(i)(E), 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, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) 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;

(ii) The business of which is to make investments that are:

(A) 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), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs) and including investments that qualify for consideration under the regulations implementing the Community Reinvestment Act (12 U.S.C. 2901 et seq.); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program;

(iii) That has elected to be regulated or is regulated as a rural business investment company, as described in 15 U.S.C. 80b-3(b)(8)(A) or (B), or that has terminated its participation as a rural business investment company in accordance with 7 CFR 4290.1900 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 termination; or

(iv) That is a qualified opportunity fund, as defined in 26 U.S.C. 1400Z-2(d).

* * * * *

(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 held under this paragraph (c)(15)(i)(C) 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 or any derivative; 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), as if the issuer were a banking entity; and

(B) Not issue asset-backed securities.

(iii) *Requirements for a sponsor, investment adviser, or commodity trading advisor*. A banking entity that acts as a sponsor, investment adviser, or commodity trading advisor to an issuer that meets the conditions in paragraphs (c)(15)(i) and (ii) of this section may not rely on this exclusion unless the banking entity:

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

(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; and

(C) Complies with the limitations imposed in § 44.14, as if the issuer were a covered fund, except the banking entity may acquire and retain any ownership interest in the issuer.

(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 under applicable federal banking laws and regulations.

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

(A) Comply with the limitations imposed in § 44.15, 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;

(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; and

(C) Complies with the restrictions in § 44.14 as if the issuer were a covered fund (except the banking entity may acquire and retain any ownership interest in the issuer).

(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 § 44.15, 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;

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

(3) The entity is owned only by family customers and up to 5 closely related persons of the family customers; and

(C) Notwithstanding paragraph (c)(17)(i)(A) and (B) of this section, up to an aggregate 0.5 percent of the entity's outstanding ownership interests may be acquired or retained by one or more entities that are not family customers or closely related persons if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity;

(D) Does not acquire or retain, as principal, an ownership interest in the entity, other than as described in paragraph (c)(17)(i)(C) of this section;

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

(F) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity 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;

(B) Notwithstanding paragraph (c)(18)(ii)(A) of this section, up to an aggregate 0.5 percent of the issuer's outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns; and

(C) 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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer;

(*4*) Do not acquire or retain, as principal, an ownership interest in the issuer, other than as described in paragraph (c)(18)(ii)(B) of this section;

(*5*) Comply with the requirements of §§ 44.14(b) and 44.15, as if such issuer were a covered fund; and

(*6*) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, 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:

(*1*) the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event; and

(*2*) the right to participate in the removal of an investment manager for “cause” or participate in the selection of a replacement manager upon an investment manager's resignation or removal. For purposes of this paragraph (d)(6)(i)(A)(*2*), “cause” for removal of an investment manager means one or more of the following events:

(i) the bankruptcy, insolvency, conservatorship or receivership of the investment manager;

(ii) the breach by the investment manager of any material provision of the covered fund’s transaction agreements applicable to the investment manager;

(iii) the breach by the investment manager of material representations or warranties;

(iv) the occurrence of an act that constitutes fraud or criminal activity in the performance of the investment manager’s obligations under the covered fund’s transaction agreements;

(v) the indictment of the investment manager for a criminal offense, or the indictment of any officer, member, partner or other principal of the investment manager for a criminal offense materially related to his or her investment management activities;

(vi) a change in control with respect to the investment manager;

(vii) the loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund's assets; or *(viii)* other similar events that constitute "cause" for removal of an investment manager, provided that such events are not solely related to the performance of the covered fund or the investment manager's exercise of investment discretion under the covered fund's transaction agreements;

(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*) Repayment of a fixed principal amount, on or before a maturity date, in a contractually-determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment);

(*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).

* * * * *

(d) * * *

(11) *Riskless principal transaction*. Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

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) will not be considered to be an affiliate of the banking entity so long as:

(A) The banking entity, together with its affiliates, 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) The banking entity, or an affiliate of the banking entity, 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 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 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.

* * * * *

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

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

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

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

(e) *Extension of time to divest an ownership interest*. (1) *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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, 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) subject to the limitations specified under 12 U.S.C. 371c(d) or § 223.42 of the Board's Regulation W (12 CFR 223.42), as applicable,

(iv) Enter into a riskless principal transaction with a covered fund; and

(v) 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), (iv) or (v) 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 under section 23B.

Subpart D — Compliance Program Requirements; Violations

7. Amend § 44.20 by:

a. Revising paragraph (a);

b. Revising paragraph (d); and

c. Revising paragraph (e).

The revisions and addition read as follows:

§ 44.20. Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities or a qualifying foreign excluded fund under section 44.6(f) or 44.13(d)) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

* * * * *

(d) *Reporting requirements under appendix A to this part*. (1) A banking entity (other than a qualifying foreign excluded fund under section 44.6(f) or 44.13(d)) engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

* * * * *

(e) *Additional documentation for covered funds*. A banking entity with significant trading assets and liabilities (other than a qualifying foreign excluded fund under section 44.6(f) or 44.13(d)) shall maintain records that include:

* * * * *

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 II of Title 12, Code of Federal Regulations as follows:

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

8. 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

9. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

Subpart C — Covered Funds Activities and Investments

10. Amend § 248.10 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);

g. Revising paragraph (d)(6); and

h. Adding paragraph (d)(11).

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 more than 75 percent of the ownership interests in the issuer are sold 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;

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

(E) Debt securities, other than asset-backed securities and convertible securities, provided that:

(*1*) the aggregate value of such debt securities does not exceed five percent of the aggregate value of loans held under paragraph (c)(8)(i)(A) of this section, cash and cash equivalents held under paragraph (c)(8)(iii)(A), and debt securities held under this paragraph (c)(8)(i)(E); and

(*2*) the aggregate value of the loans, cash and cash equivalents, and debt securities for purposes of this paragraph is calculated at par value at the most recent time any such debt security is acquired, except that the issuing entity may instead determine the value of any such loan, cash equivalent, or debt security based on its fair market value if:

(*i*) the issuing entity is required to use the fair market value of such assets for purposes of calculating compliance with concentration limitations or other similar calculations under its transaction agreements, and

(*ii*) the issuing entity's valuation methodology values similarly situated assets consistently.

(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, other than debt securities permitted under paragraph (c)(8)(i)(E), 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, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) 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;

(ii) The business of which is to make investments that are:

(A) 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), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs) and including investments that qualify for consideration under the regulations implementing the Community Reinvestment Act (12 U.S.C. 2901 et seq.); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program;

(iii) That has elected to be regulated or is regulated as a rural business investment company, as described in 15 U.S.C. 80b-3(b)(8)(A) or (B), or that has terminated its participation as a rural business investment company in accordance with 7 CFR 4290.1900 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 termination; or

(iv) That is a qualified opportunity fund, as defined in 26 U.S.C. 1400Z-2(d).

* * * * *

(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 held under this paragraph (c)(15)(i)(C) 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 or any derivative; 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;

(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; and

(C) Complies with the limitations imposed in § 248.14, as if the issuer were a covered fund, except the banking entity may acquire and retain any ownership interest in the issuer.

(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 under applicable federal banking laws and regulations.

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

(A) Comply with the limitations imposed in § 248.15, 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;

(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; and

(C) Complies with the restrictions in § 248.14 as if the issuer were a covered fund (except the banking entity may acquire and retain any ownership interest in the issuer).

(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 § 248.15, 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;

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

(3) The entity is owned only by family customers and up to 5 closely related persons of the family customers; and

(C) Notwithstanding paragraph (c)(17)(i)(A) and (B) of this section, up to an aggregate 0.5 percent of the entity's outstanding ownership interests may be acquired or retained by one or more entities that are not family customers or closely related persons if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity;

(D) Does not acquire or retain, as principal, an ownership interest in the entity, other than as described in paragraph (c)(17)(i)(C) of this section;

(E) Complies with the requirements of §§ 248.14(b) and 248.15, as if such entity were a covered fund; and

(F) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity 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;

(B) Notwithstanding paragraph (c)(18)(ii)(A) of this section, up to an aggregate 0.5 percent of the issuer’s outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns; and

(C) 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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer;

(*4*) Do not acquire or retain, as principal, an ownership interest in the issuer, other than as described in paragraph (c)(18)(ii)(B) of this section;

(*5*) Comply with the requirements of §§ 248.14(b) and 248.15, as if such issuer were a covered fund; and

(*6*) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, 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:

(*1*) the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event; and

(*2*) the right to participate in the removal of an investment manager for "cause" or participate in the selection of a replacement manager upon an investment manager's resignation or removal. For purposes of this paragraph (d)(6)(i)(A)(*2*), "cause" for removal of an investment manager means one or more of the following events:

(i) the bankruptcy, insolvency, conservatorship or receivership of the investment manager;

(ii) the breach by the investment manager of any material provision of the covered fund's transaction agreements applicable to the investment manager;

(iii) the breach by the investment manager of material representations or warranties;

(iv) the occurrence of an act that constitutes fraud or criminal activity in the performance of the investment manager's obligations under the covered fund's transaction agreements;

(v) the indictment of the investment manager for a criminal offense, or the indictment of any officer, member, partner or other principal of the investment manager for a criminal offense materially related to his or her investment management activities;

(vi) a change in control with respect to the investment manager;

(vii) the loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund's assets; or

(viii) other similar events that constitute "cause" for removal of an investment manager, provided that such events are not solely related to the performance of the covered fund or the investment manager's exercise of investment discretion under the covered fund's transaction agreements;

(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*) Repayment of a fixed principal amount, on or before a maturity date, in a contractually-determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment);

(*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).

* * * * *

(d) * * *

(11) *Riskless principal transaction*. Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

11. 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:

(A) The banking entity, together with its affiliates, 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) The banking entity, or an affiliate of the banking entity, 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 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.

* * * * *

(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.

12. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

13. 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) subject to

the limitations specified under 12 U.S.C. 371c(d) or § 223.42 of the Board's Regulation W (12 CFR 223.42), as applicable,

(iv) Enter into a riskless principal transaction with a covered fund; and

(v) 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), (iv) or (v) 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 under section 23B.

Subpart D — Compliance Program Requirements; Violations

14. Amend § 248.20 by:

a. Revising paragraph (a);

b. Revising paragraph (d); and

c. Revising paragraph (e).

The revisions and addition read as follows:

§ 248.20. Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities or a qualifying foreign excluded fund under section 248.6(f) or 248.13(d)) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

* * * * *

(d) *Reporting requirements under appendix A to this part*. (1) A banking entity (other than a qualifying foreign excluded fund under section 248.6(f) or 248.13(d)) engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

* * * * *

(e) *Additional documentation for covered funds*. A banking entity with significant trading assets and liabilities (other than a qualifying foreign excluded fund under section 248.6(f) or 248.13(d)) shall maintain records that include:

* * * * *

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

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

15. 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

16. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

Subpart C — Covered Funds Activities and Investments

17. 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);

g. Revising paragraph (d)(6); and

h. Adding paragraph (d)(11).

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 more than 75 percent of the ownership interests in the issuer are sold 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;

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

(E) Debt securities, other than asset-backed securities and convertible securities, provided that:

(*1*) the aggregate value of such debt securities does not exceed five percent of the aggregate value of loans held under paragraph (c)(8)(i)(A) of this section, cash and cash equivalents held under paragraph (c)(8)(iii)(A), and debt securities held under this paragraph (c)(8)(i)(E); and

(*2*) the aggregate value of the loans, cash and cash equivalents, and debt securities for purposes of this paragraph is calculated at par value at the most recent time any such debt security is acquired, except that the issuing entity may instead determine the value of any such loan, cash equivalent, or debt security based on its fair market value if:

(*i*) the issuing entity is required to use the fair market value of such assets for purposes of calculating compliance with concentration limitations or other similar calculations under its transaction agreements, and

(*ii*) the issuing entity's valuation methodology values similarly situated assets consistently.

(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, other than debt securities permitted under paragraph (c)(8)(i)(E), 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, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) 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;

(ii) The business of which is to make investments that are:

(A) 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), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs) and including investments that qualify for consideration under the regulations implementing the Community Reinvestment Act (12 U.S.C. 2901 et seq.); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program;

(iii) That has elected to be regulated or is regulated as a rural business investment company, as described in 15 U.S.C. 80b-3(b)(8)(A) or (B), or that has terminated its participation as a rural business investment company in accordance with 7 CFR 4290.1900 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 termination; or

(iv) That is a qualified opportunity fund, as defined in 26 U.S.C. 1400Z-2(d).

* * * * *

(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 held under this paragraph (c)(15)(i)(C) 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 or any derivative; 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), 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) of this subpart, as if the issuer were a covered fund;

(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; and

(C) Complies with the limitations imposed in § 351.14, as if the issuer were a covered fund, except the banking entity may acquire and retain any ownership interest in the issuer.

(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 under applicable federal banking laws and regulations.

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

(A) Comply with the limitations imposed in § 351.15, 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;

(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; and

(C) Complies with the restrictions in § 351.14 as if the issuer were a covered fund (except the banking entity may acquire and retain any ownership interest in the issuer).

(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 § 351.15, 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;

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

(3) The entity is owned only by family customers and up to 5 closely related persons of the family customers; and

(C) Notwithstanding paragraph (c)(17)(i)(A) and (B) of this section, up to an aggregate 0.5 percent of the entity's outstanding ownership interests may be acquired or retained by one or more entities that are not family customers or closely related persons if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity;

(D) Does not acquire or retain, as principal, an ownership interest in the entity, other than as described in paragraph (c)(17)(i)(C) of this section;

(E) Complies with the requirements of §§ 351.14(b) and 351.15, as if such entity were a covered fund; and

(F) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity 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;

(B) Notwithstanding paragraph (c)(18)(ii)(A) of this section, up to an aggregate 0.5 percent of the issuer's outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns; and

(C) 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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer;

(*4*) Do not acquire or retain, as principal, an ownership interest in the issuer, other than as described in paragraph (c)(18)(ii)(B) of this section;

(*5*) Comply with the requirements of §§ 351.14(b) and 351.15, as if such issuer were a covered fund; and

(*6*) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, 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:

(*1*) the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event; and

(*2*) the right to participate in the removal of an investment manager for "cause" or participate in the selection of a replacement manager upon an investment manager's resignation or removal. For purposes of this paragraph (d)(6)(i)(A)(*2*), "cause" for removal of an investment manager means one or more of the following events:

(i) the bankruptcy, insolvency, conservatorship or receivership of the investment manager;

(ii) the breach by the investment manager of any material provision of the covered fund's transaction agreements applicable to the investment manager;

(iii) the breach by the investment manager of material representations or warranties;

(iv) the occurrence of an act that constitutes fraud or criminal activity in the performance of the investment manager's obligations under the covered fund's transaction agreements;

(v) the indictment of the investment manager for a criminal offense, or the indictment of any officer, member, partner or other principal of the investment manager for a criminal offense materially related to his or her investment management activities;

(vi) a change in control with respect to the investment manager;

(vii) the loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund's assets; or

(viii) other similar events that constitute "cause" for removal of an investment manager, provided that such events are not solely related to the performance of the covered fund or the investment manager's exercise of investment discretion under the covered fund's transaction agreements;

(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*) Repayment of a fixed principal amount, on or before a maturity date, in a contractually-determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment);

(*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).

* * * * *

(d) * * *

(11) *Riskless principal transaction*. Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

18. 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:

(A) The banking entity, together with its affiliates, 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) The banking entity, or an affiliate of the banking entity, 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 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.

* * * * *

(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) 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 § 351.10(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.

19. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

20. 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) subject to the limitations specified under 12 U.S.C. 371c(d) or § 223.42 of the Board's Regulation W (12 CFR 223.42), as applicable,

(iv) Enter into a riskless principal transaction with a covered fund; and

(v) 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), (iv) or (v) must comply with the limitations in § 351.15.

* * * * *

(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 under section 23B.

Subpart D — Compliance Program Requirements; Violations

21. Amend § 351.20 by:

a. Revising paragraph (a);

b. Revising paragraph (d); and

c. Revising paragraph (e).

The revisions and addition read as follows:

§ 351.20. Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities or a qualifying foreign excluded fund under section 351.6(f) or 351.13(d)) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary

trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

* * * * *

(d) *Reporting requirements under appendix A to this part*. (1) A banking entity (other than a qualifying foreign excluded fund under section 351.6(f) or 351.13(d)) engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

* * * * *

(e) *Additional documentation for covered funds*. A banking entity with significant trading assets and liabilities (other than a qualifying foreign excluded fund under section 351.6(f) or 351.13(d)) shall maintain records that include:

* * * * *

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

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

Authority: 12 U.S.C. 1851.

Subpart B — Proprietary Trading

23. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

Subpart C — Covered Funds Activities and Investments

24. 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);

g. Revising paragraph (d)(6); and

h. Adding paragraph (d)(11).

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 more than 75 percent of the ownership interests in the issuer are sold 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;

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

(E) Debt securities, other than asset-backed securities and convertible securities, provided that:

(*1*) the aggregate value of such debt securities does not exceed five percent of the aggregate value of loans held under paragraph (c)(8)(i)(A) of this section, cash and cash equivalents held under paragraph (c)(8)(iii)(A), and debt securities held under this paragraph (c)(8)(i)(E); and

(*2*) the aggregate value of the loans, cash and cash equivalents, and debt securities for purposes of this paragraph is calculated at par value at the most recent time any such debt security is

acquired, except that the issuing entity may instead determine the value of any such loan, cash equivalent, or debt security based on its fair market value if:

(*i*) the issuing entity is required to use the fair market value of such assets for purposes of calculating compliance with concentration limitations or other similar calculations under its transaction agreements, and

(*ii*) the issuing entity's valuation methodology values similarly situated assets consistently.

(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, other than debt securities permitted under paragraph (c)(8)(i)(E), 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, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) 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;

(ii) The business of which is to make investments that are:

(A) 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), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs) and including investments that qualify for consideration under the regulations implementing the Community Reinvestment Act (12 U.S.C. 2901 et seq.); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program;

(iii) That has elected to be regulated or is regulated as a rural business investment company, as described in 15 U.S.C. 80b-3(b)(8)(A) or (B), or that has terminated its participation as a rural business investment company in accordance with 7 CFR 4290.1900 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 termination; or

(iv) That is a qualified opportunity fund, as defined in 26 U.S.C. 1400Z-2(d).

* * * * *

(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 held under this paragraph (c)(15)(i)(C) 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 or any derivative; 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) of this subpart, as if the issuer were a covered fund;

(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; and

(C) Complies with the limitations imposed in § 75.14, as if the issuer were a covered fund, except the banking entity may acquire and retain any ownership interest in the issuer.

(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 under applicable federal banking laws and regulations.

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

(A) Comply with the limitations imposed in § 75.15, 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;

(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; and

(C) Complies with the restrictions in § 75.14 as if the issuer were a covered fund (except the banking entity may acquire and retain any ownership interest in the issuer).

(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 § 75.15, 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;

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

(3) The entity is owned only by family customers and up to 5 closely related persons of the family customers; and

(C) Notwithstanding paragraph (c)(17)(i)(A) and (B) of this section, up to an aggregate 0.5 percent of the entity's outstanding ownership interests may be acquired or retained by one or more entities that are not family customers or closely related persons if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity;

(D) Does not acquire or retain, as principal, an ownership interest in the entity, other than as described in paragraph (c)(17)(i)(C) of this section;

(E) Complies with the requirements of §§ 75.14(b) and 75.15, as if such entity were a covered fund; and

(F) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity 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;

(B) Notwithstanding paragraph (c)(18)(ii)(A) of this section, up to an aggregate 0.5 percent of the issuer's outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns; and

(C) 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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer;

(*4*) Do not acquire or retain, as principal, an ownership interest in the issuer, other than as described in paragraph (c)(18)(ii)(B) of this section;

(*5*) Comply with the requirements of §§ 75.14(b) and 75.15, as if such issuer were a covered fund; and

(*6*) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, 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:

(*1*) the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event; and

(*2*) the right to participate in the removal of an investment manager for “cause” or participate in the selection of a replacement manager upon an investment manager's resignation or removal. For purposes of this paragraph (d)(6)(i)(A)(*2*), “cause” for removal of an investment manager means one or more of the following events:

(i) the bankruptcy, insolvency, conservatorship or receivership of the investment manager;

(ii) the breach by the investment manager of any material provision of the covered fund’s transaction agreements applicable to the investment manager;

(iii) the breach by the investment manager of material representations or warranties;

(iv) the occurrence of an act that constitutes fraud or criminal activity in the performance of the investment manager’s obligations under the covered fund’s transaction agreements;

(v) the indictment of the investment manager for a criminal offense, or the indictment of any officer, member, partner or other principal of the investment manager for a criminal offense materially related to his or her investment management activities;

(vi) a change in control with respect to the investment manager;

(vii) the loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund's assets; or

(viii) other similar events that constitute "cause" for removal of an investment manager, provided that such events are not solely related to the performance of the covered fund or the investment manager's exercise of investment discretion under the covered fund's transaction agreements;

(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*) Repayment of a fixed principal amount, on or before a maturity date, in a contractually-determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment);

(*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).

* * * * *

(d) * * *

(11) *Riskless principal transaction*. Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

26. Amend § 75.12 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:

§ 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) will not be considered to be an affiliate of the banking entity so long as:

(A) The banking entity, together with its affiliates, 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) The banking entity, or an affiliate of the banking entity, 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 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)), 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 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.

* * * * *

(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) 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 § 75.10(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.

26. Amend § 75.13 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

27. 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) subject to the limitations specified under 12 U.S.C. 371c(d) or § 223.42 of the Board's Regulation W (12 CFR 223.42), as applicable,

(iv) Enter into a riskless principal transaction with a covered fund; and

(v) 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), (iv) or (v) 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 under section 23B.

Subpart D — Compliance Program Requirements; Violations

28. Amend § 75.20 by:

a. Revising paragraph (a);

b. Revising paragraph (d); and

c. Revising paragraph (e).

The revisions and addition read as follows:

§ 75.20. Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities or a qualifying foreign excluded fund under section 75.6(f) or 75.13(d)) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

* * * * *

(d) *Reporting requirements under appendix A to this part*. (1) A banking entity (other than a qualifying foreign excluded fund under section 75.6(f) or 75.13(d)) engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

* * * * *

(e) *Additional documentation for covered funds*. A banking entity with significant trading assets and liabilities (other than a qualifying foreign excluded fund under section 75.6(f) or 75.13(d)) shall maintain records that include:

* * * * *

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

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

Authority: 12 U.S.C. 1851.

Subpart B — Proprietary Trading

30. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

Subpart C — Covered Funds Activities and Investments

31. 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);

g. Revising paragraph (d)(6); and

h. Adding paragraph (d)(11).

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 more than 75 percent of the ownership interests in the issuer are sold 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 § 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;

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

(E) Debt securities, other than asset-backed securities and convertible securities, provided that:

(*1*) the aggregate value of such debt securities does not exceed five percent of the aggregate value of loans held under paragraph (c)(8)(i)(A) of this section, cash and cash equivalents held under paragraph (c)(8)(iii)(A), and debt securities held under this paragraph (c)(8)(i)(E); and

(*2*) the aggregate value of the loans, cash and cash equivalents, and debt securities for purposes of this paragraph is calculated at par value at the most recent time any such debt security is acquired, except that the issuing entity may instead determine the value of any such loan, cash equivalent, or debt security based on its fair market value if:

(*i*) the issuing entity is required to use the fair market value of such assets for purposes of calculating compliance with concentration limitations or other similar calculations under its transaction agreements, and

(*ii*) the issuing entity's valuation methodology values similarly situated assets consistently.

(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, other than debt securities permitted under paragraph (c)(8)(i)(E), 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, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section, or the debt securities described in paragraph (c)(8)(i)(E) 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;

(ii) The business of which is to make investments that are:

(A) 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), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs) and including investments that qualify for consideration under the regulations implementing the Community Reinvestment Act (12 U.S.C. 2901 et seq.); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program;

(iii) That has elected to be regulated or is regulated as a rural business investment company, as described in 15 U.S.C. 80b-3(b)(8)(A) or (B), or that has terminated its participation as a rural business investment company in accordance with 7 CFR 4290.1900 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 termination; or

(iv) That is a qualified opportunity fund, as defined in 26 U.S.C. 1400Z-2(d).

* * * * *

(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 held under this paragraph (c)(15)(i)(C) 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 or any derivative; 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), 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;

(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; and

(C) Complies with the limitations imposed in § 255.14, as if the issuer were a covered fund, except the banking entity may acquire and retain any ownership interest in the issuer.

(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 under applicable federal banking laws and regulations.

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

(A) Comply with the limitations imposed in § 255.15, 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;

(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; and

(C) Complies with the restrictions in § 255.14 as if the issuer were a covered fund (except the banking entity may acquire and retain any ownership interest in the issuer).

(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 § 255.15, 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;

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

(3) The entity is owned only by family customers and up to 5 closely related persons of the family customers; and

(C) Notwithstanding paragraph (c)(17)(i)(A) and (B) of this section, up to an aggregate 0.5 percent of the entity's outstanding ownership interests may be acquired or retained by one or more entities that are not family customers or closely related persons if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the entity;

(D) Does not acquire or retain, as principal, an ownership interest in the entity, other than as described in paragraph (c)(17)(i)(C) of this section;

(E) Complies with the requirements of §§ 255.14(b) and 255.15, as if such entity were a covered fund; and

(F) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, complies with the requirements of 12 CFR 223.15(a), as if such banking entity and its affiliates were a member bank and the entity 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;

(B) Notwithstanding paragraph (c)(18)(ii)(A) of this section, up to an aggregate 0.5 percent of the issuer’s outstanding ownership interests may be acquired or retained by one or more entities that are not customers if the ownership interest is acquired or retained by such parties for the purpose of and to the extent necessary for establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns; and

(C) 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, provided that the content may be modified to prevent the disclosure from being misleading and the manner of disclosure may be modified to accommodate the specific circumstances of the issuer;

(*4*) Do not acquire or retain, as principal, an ownership interest in the issuer, other than as described in paragraph (c)(18)(ii)(B) of this section;

(*5*) Comply with the requirements of §§ 255.14(b) and 255.15, as if such issuer were a covered fund; and

(*6*) Except for riskless principal transactions as defined in paragraph (d)(11) of this section, 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:

(*1*) the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event; and

(*2*) the right to participate in the removal of an investment manager for "cause" or participate in the selection of a replacement manager upon an investment manager's resignation or removal. For purposes of this paragraph (d)(6)(i)(A)(*2*), "cause" for removal of an investment manager means one or more of the following events:

(i) the bankruptcy, insolvency, conservatorship or receivership of the investment manager;

(ii) the breach by the investment manager of any material provision of the covered fund's transaction agreements applicable to the investment manager;

(iii) the breach by the investment manager of material representations or warranties;

(iv) the occurrence of an act that constitutes fraud or criminal activity in the performance of the investment manager's obligations under the covered fund's transaction agreements;

(v) the indictment of the investment manager for a criminal offense, or the indictment of any officer, member, partner or other principal of the investment manager for a criminal offense materially related to his or her investment management activities;

(vi) a change in control with respect to the investment manager;

(vii) the loss, separation or incapacitation of an individual critical to the operation of the investment manager or primarily responsible for the management of the covered fund's assets; or

(viii) other similar events that constitute "cause" for removal of an investment manager, provided that such events are not solely related to the performance of the covered fund or the investment manager's exercise of investment discretion under the covered fund's transaction agreements;

(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*) Repayment of a fixed principal amount, on or before a maturity date, in a contractually-determined manner (which may include prepayment premiums intended solely to reflect, and compensate holders of the interest for, forgone income resulting from an early prepayment);

(*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).

* * * * *

(d) * * *

(11) *Riskless principal transaction*. Riskless principal transaction means a transaction in which a banking entity, after receiving an order from a customer to buy (or sell) a security, purchases (or sells) the security in the secondary market for its own account to offset a contemporaneous sale to (or purchase from) the customer.

32. 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) will not be considered to be an affiliate of the banking entity so long as:

(A) The banking entity, together with its affiliates, 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) The banking entity, or an affiliate of the banking entity, 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 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 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.

* * * * *

(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) 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 § 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.

33. 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 the banking entity that sponsors or controls the qualifying foreign excluded fund, or any of its affiliates, to evade the requirements of section 13 of the BHC Act or this part.

34. 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) subject to

the limitations specified under 12 U.S.C. 371c(d) or § 223.42 of the Board's Regulation W (12 CFR 223.42), as applicable,

(iv) Enter into a riskless principal transaction with a covered fund; and

(v) 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), (iv) or (v) must comply with the limitations in § 255.15.

* * * * *

(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 under section 23B.

Subpart D — Compliance Program Requirements; Violations

35. Amend § 255.20 by:

a. Revising paragraph (a);

b. Revising paragraph (d); and

c. Revising paragraph (e).

The revisions and addition read as follows:

§ 255.20. Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities or a qualifying foreign excluded fund under section 255.6(f) or 255.13(d)) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

* * * * *

(d) *Reporting requirements under appendix A to this part*. (1) A banking entity (other than a qualifying foreign excluded fund under section 255.6(f) or 255.13(d)) engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

* * * * *

(e) *Additional documentation for covered funds*. A banking entity with significant trading assets and liabilities (other than a qualifying foreign excluded fund under section 255.6(f) or 255.13(d)) shall maintain records that include:

* * * * *

Brian P. Brooks
Acting Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System.

Ann E. Misback,
Secretary of the Board.

Federal Deposit Insurance Corporation.
By order of the Board of Directors.
Dated at Washington, DC, on or about [•].

Robert E. Feldman,
Executive Secretary.

Issued in Washington, DC, on [•] by the Commission

Robert Sidman,
Deputy Secretary of the Commission.

By the Securities and Exchange Commission
Dated: [•].

Vanessa A. Countryman,
Secretary.