Federal Agencies Adopt Amendments to Volcker Rule

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The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodity Futures Trading Commission (together, Agencies) on June 25, 2020 adopted a final rule (Final Rule)[1] amending certain provisions of the regulations implementing the so-called "Volcker Rule."[2] The Final Rule's amendments, which relate to the provisions of the regulations implementing the Volcker Rule (Volcker Rule Regulations) dealing with "covered funds," are substantially the same as those the Agencies proposed for comment earlier in 2020, although the Agencies made certain changes to the proposal in response to comments, as discussed below.

The Final Rule will take effect on October 1, 2020.

With the Final Rule, the Agencies seek to: limit certain unintended consequences of the Volcker Rule Regulations; reduce their extraterritorial impact; and generally streamline the provisions relating to covered funds – while maintaining, and in some cases improving, consistency with the requirements and purpose of the Volcker Rule. This *Dechert OnPoint* summarizes key aspects of the Final Rule, including:

- New exclusions from the covered fund definition for credit funds, venture capital funds, family wealth management vehicles, and customer facilitation vehicles;
- Revisions to existing exclusions from the covered fund definition for foreign public (retail) funds, loan securitizations, and public welfare and small business funds;
- Modification of the definition of "ownership interest" under the Volcker Rule Regulations to clarify that: an ownership interest in a covered fund does not include bona fide senior loans or senior debt instruments, and certain types of creditor rights do not give rise to an ownership interest;
- Codification of an existing policy statement by the OCC, the Board, and the FDIC to address situations where a foreign fund that is not a covered fund could be deemed to be a banking entity;
- Clarification that in certain circumstances, a banking entity is not required to treat investments by the banking entity or its directors or employees alongside a covered fund as investments by the banking entity in the covered fund itself; and
- Modifications to the so called "Super 23A" provisions of the Volcker Rule to allow a banking entity to make certain short-term extensions of credit to covered funds advised or sponsored by their baking entity or its affiliates and engage in riskless principal transactions with such funds.

Qualifying Foreign Excluded Funds

To the relief of many non-U.S. asset managers, the Final Rule grants permanent relief for qualifying foreign excluded funds from the negative consequences that otherwise could have attached to such funds due to the Volcker Rule's broad definition of "banking entity." More specifically, to the extent a qualifying foreign excluded fund is controlled by a foreign banking entity, it would be treated as a banking entity directly subject to the Volcker Rule's restrictions on proprietary trading and acquiring ownership interests in covered funds, despite the fact such funds have limited or no

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[1] To be codified at 12 C.F.R. pt. 44, 12 C.F.R. pt. 248, 12 C.F.R. pt. 351, 17 C.F.R. pt. 75, and 17 C.F.R. At times, this *OnPoint* tracks the Final Rule and other statues and rules without the use of quotation marks.

[2] Section 13 of the Bank Holding Company Act of 1956.

connection to the United States. Although the Final Rule does not exclude them from the definition of a banking entity, qualifying foreign excluded funds are exempted from both the proprietary trading and covered fund restrictions. In addition, the Final Rule exempts qualifying foreign excluded funds from the requirement to maintain a compliance program.

The Final Rule defines a "qualifying foreign excluded fund" as a banking entity that:

- Is organized or established outside the United States, and the ownership interests of which are offered and sold solely outside the United States;
- Would be a covered fund if the entity were 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;
- 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 a non-U.S. banking entity whose 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;
- Is established and operated as part of a bona fide asset management business; and
- 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 the Volcker Rule or the Volcker Rule Regulations.

Modifications to Existing Covered Fund Exclusions

The Final Rule modifies existing exclusions from the definition of covered fund relating to foreign public funds and loan securitizations. The Agencies explained that these modifications were intended to make these existing exclusions "more appropriately structured to effectuate the intent of the [Volcker Rule] and [the Volcker Rule Regulations]."[3]

Foreign Public Funds Exclusion

The Final Rule makes a number of modifications to the exclusion from the definition of covered fund available to foreign public funds, which the Agencies indicated would "make the foreign public fund exclusion more effective by expanding its availability, providing clarity, and simplifying compliance with its requirements." The foreign public funds exclusion is designed to provide consistent treatment for foreign funds that are publicly offered to retail investors and U.S.-registered investment companies, which fall outside the Volcker Rule Regulations' definition of covered fund. In adopting the Final Rule's modifications, the Agencies acknowledged that certain of the existing requirements: imposed limitations that were more burdensome than those applied to U.S.-registered funds; required compliance with conditions that "may be difficult or impossible for a banking entity … to know"; and/or were inconsistent with certain characteristics of how foreign public funds are organized and offered. To address these concerns, the Final Rule modifies the foreign public funds exclusion as follows:

3 Adopting Release at 23.

- The requirements that a foreign public fund be authorized to offer and sell interests to retail investors in the fund's home jurisdiction and that the fund's interests be sold predominantly through one or more public offerings outside of the United States are replaced with a requirement that the fund's interests be sold in a "public offering" (the definition of which is modified in the Final Rule, as discussed below).

- A banking entity may rely on the foreign public funds exclusion with respect to a foreign public fund that it sponsors, provided that more than 75% of the foreign fund's ownership interests are sold to persons other than: the banking entity itself; the foreign public fund; affiliates of the banking entity or the foreign public fund; or directors and senior executive officers of the banking entity. The existing Volcker Rule Regulations, in contrast, impose a higher 85% threshold and extend the list of related persons to include all employees of the banking entity.

- The definition of "public offering" is amended to require that a qualifying distribution must be subject to substantive disclosure and retail investor protection laws or regulations. In addition, recognizing the limitations of banking entities' ability to monitor the distribution activities of unaffiliated foreign funds, the Final Rule limits the requirement that a public offering comply with all applicable regulations in the jurisdiction in which it is being made, to instances in which the banking entity manages or sponsors the foreign public fund.

Loan Securitization Exclusion

Responding to repeated requests from industry participants, the Agencies revised the "loan securitization" exclusion from the definition of covered fund, to permit loan securitizations to hold debt securities (other than asset-backed securities and convertible securities) for up to 5% of their eligible assets – thereby allowing the "bond buckets" that were common in the collateralized loan obligation (CLO) market prior to the enactment of the Volcker Rule. This 5% limit is to be tested at the most recent time of acquisition of a debt security, and based on par value, except that fair market values may be used in certain circumstances if the issuer consistently uses fair market value to value similar assets. Almost as significant as the permission itself, the Agencies clarified in the release accompanying the adoption of the Final Rule (Adopting Release)[4] that amendments to this exclusion "would permit an issuer … to qualify for the exclusion if it came into compliance with the five percent limit prior to a banking entity relying on the exclusion with respect to such issuer,"[5] thus confirming for the first time that an issuer is not permanently ineligible for the exclusion if it previously held ineligible assets, as long as the issuer disposes of those assets to bring itself into compliance.

Public Welfare Funds Exclusion

The proposal generated significant feedback in response to the Agencies' request for comment on the types of investments that are designed primarily to promote the public welfare and the welfare of low- and moderate-income communities or families and, therefore, qualify for the exclusion from being a covered fund in § __.10(c)(11) of the Volcker Rule Regulations. In response to commenters' feedback, the Final Rule expressly excludes from the definition of covered fund, issuers that make investments qualifying for consideration under the Community Reinvestment Act's regulations and Rural Business Investment Companies and qualified opportunity funds – all programs designed to promote economic development and job creation in rural and low-income communities. While issuers that make investments through these programs may have qualified under the existing rule's public welfare

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4 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (June 25, 2020).

5 Adopting Release at 45.

investment exclusion, their explicit exclusion in the Final Rule removes any uncertainty concerning such investments. Notably, however, public welfare funds do not have an exclusion from the definition of "banking entity." The Agencies observed that they expected that banking entities generally would be able to structure their investments in public welfare funds so as to avoid causing such funds to become banking entities. The Agencies further noted that, even if a public welfare fund were a banking entity, it would benefit from 2019 amendments that would mitigate its compliance burdens.[6]

The existing rule also excludes from the definition of covered fund Small Business Investment Companies (SBICs) and issuers that have received valid notice from the Small Business Administration to proceed to qualify for a license as an SBIC. In response to supportive comments, the Final Rule includes provisions expanding the exclusion to cover issuers that voluntarily surrender their licenses to operate as an SBIC and do not make any new investments (other than investments in cash equivalents) in connection with winding down their businesses. This revision is designed to support capital formation for small businesses, by addressing banking entities' potential concerns about investing in SBICs due to the possibility that an SBIC could become a covered fund during its wind-down phase. To address concerns regarding potential abuse and evasion, the Agencies added further safeguards to the Final Rule, including that the surrender of the SBIC license must have been voluntary.

Additional Covered Fund Exclusions

In addition to modifying the existing exclusions from the definition of covered fund discussed above, the Final Rule establishes four new categories of exclusions: credit funds; venture capital funds; family wealth management vehicles; and customer facilitation vehicles. The Agencies observed that these new exclusions were designed to "better tailor the provisions to the types of entities that the [Volcker Rule] was intended to cover."[7]

Credit Funds

The first of these new exclusions, the Credit Fund Exclusion, allows banking entities to invest in, sponsor, advise, and/or have certain other relationships with, a credit fund that meets specified requirements (an Excluded Credit Fund).[8] For a banking entity to treat a fund as an Excluded Credit Fund, the following five specific sets of requirements must be met (to the extent applicable):

- *Asset Requirements.* The fund's assets are limited to:
  - Loans;
  - Debt instruments;

6 Adopting Release at 54.

7 Adopting Release at 57.

8 As observed by the Agencies, "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." Thus, each banking entity seeking to sponsor, manage, invest in, or deal with a fund that might rely on the exclusion, must determine, given the nature of the Credit Fund Exclusion, whether the fund meets the exclusion's terms based on the banking entity's particular circumstances, as "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." Adopting Release at 79.

- Rights/assets related or incidental to acquiring, holding, servicing, or selling loans or debt instruments[9]; and
- Certain interest rate or foreign exchange derivatives that relate to the above and reduce the interest rate and/or foreign exchange risks related thereto.[10]

- *Activity Requirements.* The fund may not
  - Engage in trading that would be proprietary trading if the fund were a banking entity; or
  - Issue asset-backed securities.
- *Sponsor/Adviser Requirements.* A banking entity that sponsors or acts as an investment adviser or commodity trading advisor to a fund that seeks to rely on the exclusion must:
  - Provide written disclosure to investors and prospective investors (as would be required if the fund were a covered fund);
  - Ensure that the activities of the issuer are consistent with safety and soundness standards that would be applicable if the banking entity engaged in the activity directly; and
  - Comply with the limitations imposed in § __.14 of the Volcker Rule Regulations (Limitations on Relationships with a Covered Fund),[11] except that a banking entity can acquire and retain an ownership interest in the fund.
- *Other Banking Entity Requirements*. The banking entity seeking to rely on the exclusion must:
  - Not, directly or indirectly, guarantee, assume or otherwise insure the obligation or performance of the fund or any fund borrower or portfolio investment; and
  - Assure that any debt instruments (other than loans) or equity securities or rights that the issuer holds would be permissible for the banking entity to hold directly.

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9 Rights and other assets are limited to "cash equivalents, securities 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 loan or debt instruments." There is no percentage limit on equity securities or rights, but the exclusion requires that these 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." Adopting Release at footnote 220. The Agencies expressed their expectation that equity securities or rights will not exceed 5% of the fund's total investment at the time the investment is made.

10 The Final Rule explicitly excludes derivatives from permissible related rights and other assets, to ensure that the Credit Fund Exclusion does not inadvertently allow the holding of certain derivatives unrelated to interest rate and/or foreign exchange risks.

11 The Agencies confirmed that the § __.14 limitations do not apply to a banking entity that merely invests in a credit fund. However, § __.14, does apply to banking entities that serve as an investment manager, investment adviser, commodity trading adviser or sponsor to a credit fund.

- *Investment and Relationship Limits.* To rely on the exclusion with respect to a fund, the banking entity's relationship with or investment in the fund must:
  - Comply with § __.15 of the Volcker Rule Regulations (Other Limitations on Permitted Covered Fund Activities) as if the fund were a covered fund; and
  - Comport with, and be subject to, relevant banking laws and regulations, including with respect to safety and soundness.

Venture Capital Funds

The Final Rule also establishes an exclusion from the definition of covered fund for qualifying venture capital funds. In the Adopting Release, the Agencies expressed their belief that this exclusion would: facilitate capital formation and financing; promote job creation; and foster economic growth with respect to small businesses and start-up companies. The Agencies also stated their belief that the exclusion is consistent with the purpose of the Volcker Rule, because the activities of venture capital funds do not present risks contemplated by the Volcker Rule.

For purposes of the exclusion, a qualifying venture capital fund is a fund that meets the definition of a "venture capital fund" in the SEC's Rule 203(*l*)-1 under the Investment Advisers Act of 1940. Under this rule, a venture capital fund is any private fund that: (1) conveys to investors and prospective investors that the fund utilizes a venture capital strategy; (2) immediately after acquiring an asset, excluding "qualifying investments"[12] or short-term holdings, holds no more than 20% of the fund's total capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, regularly applied by the fund; (3) does not incur debt or leverage in excess of 15% of the fund's total capital contributions and uncalled committed capital (and any debt or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee of the obligations of a "qualifying portfolio company,"[13] up to the amount of the value of the fund's investment in such portfolio company, is not subject to this limit); (4) issues only securities that do not grant the holder any right to withdraw, redeem or require the repurchase of such securities, but may allow holders to receive distributions made to all holders pro rata; and (5) is not registered under Section 8 of the Investment Company Act, and is not a business development company.

The Final Rule imposes the requirement that a qualifying venture capital fund cannot engage in any activity that would constitute proprietary trading as defined in § __.3(b)(1)(i) of the Volcker Rule Regulations, as if the fund were a banking entity. The Final Rule also requires that a banking entity that serves as a sponsor, investment adviser or

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12 A "qualifying investment" means: (i) an equity security issued by a qualifying portfolio company that has been acquired directly by a private fund from the qualifying portfolio company; (ii) any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company described in (i); or (iii) 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 of 1940, or a predecessor entity, and is acquired by the private fund in exchange for an equity security described in (i) or (ii). *See* 17 CFR § 275.203(*l*)-1(c)(3).

13 "Qualifying portfolio company" means any company that: (1) at the time of any investment by the private fund, is not reporting or foreign traded and does not control, is not controlled by or under common control with another company, directly or indirectly, that is reporting or foreign traded; (2) does not borrow or issue debt obligations in connection with the private fund's investment in such company, and distribute to the private fund the proceeds of such borrowing or issuance in exchange for the private fund's investment; and (3) is not an investment company, a private fund, or an issuer that would be an investment company but for the exemption provided by 17 CFR § 270.3a-7, or a commodity pool. *See* 17 CFR § 275.203(l)-1(c)(4).

commodity trading advisor to a qualifying venture capital fund must provide to prospective and actual investors in the fund the disclosures required under § __.11(a)(8) of the Volcker Rule Regulations before the banking entity relies on the exclusion. These disclosures generally inform investors that the banking entities will not "bail out" the qualifying venture capital fund, and also highlight the role of the banking entity and any affiliates in sponsoring or providing any services to the qualifying venture capital fund. A banking entity that serves as a sponsor, investment adviser or commodity trading advisor to a qualifying venture capital fund also must verify that the activities of such fund are consistent with safety and soundness standards similar to those that would apply if the banking entity were directly engaged in such activities.

Additionally, to prevent banking entities from "bailing out" a qualifying venture capital fund, the Final Rule prohibits a banking entity from guaranteeing, assuming or otherwise insuring the obligations or performance of the fund.[14] The Final Rule further states that a banking entity's ownership or relationship with a qualifying venture capital fund must comply with § __.15 of the Volcker Rule Regulations (Other Limitations on Permitted Covered Fund Activities) and be in compliance with applicable banking laws and regulations, as if the issuer were a covered fund.[15]

Family Wealth Management Vehicles and Customer Facilitation Vehicles

The new exclusions for family wealth management vehicles (Family Vehicles) and customer facilitation vehicles (Customer Vehicles) recognize that these differ qualitatively from other types of private funds that are considered covered funds under the Volcker Rule Regulations.[16] Fundamentally, Family Vehicles and Customer Vehicles that meet the parameters of the new exclusions reflect solutions tailored to specific customers, rather than hedge or private equity funds designed for sale to a broader set of investors. In the view of the Agencies, the exclusions will allow banks to more comfortably provide the type of client-oriented financial and asset management services that have traditionally been provided to customers and which do not involve the types of risks the Volcker Rule was intended to address.[17] In the Agencies view, moreover, with the application of the requirements described below, provision of these customer-oriented services through a fund structure (in addition to via more traditional trusts in the case of Family Vehicles) are unlikely to result in improper evasion of the Volcker Rule.[18] As such, the Family Vehicle and Customer Vehicle exclusions will allow banks, bank-related entities, and their customers, to structure efficient asset management solutions while retaining the fundamental protections of the Volcker Rule.

Families or their family offices often create a pooled vehicle (*e.g.*, a trust, limited partnership or limited liability company) to facilitate the management of family assets and the growth and generational transfer of family wealth. These entities typically do not raise money in the traditional sense but, instead, pool family assets for investment. The exclusion is available to a family for any such vehicle if the vehicle is principally owned by the family. For trusts, each grantor must be a "family customer" (which is a slightly expanded version of "family client" under Rule 202(a)(11)(G)-1 under the Advisers Act, adding in-laws of a family client as well as those in-laws' spouses or spousal equivalents). For other types of entities seeking to rely on this exclusion, ownership generally is limited to family customers and a

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14 Final Rule § __.10(c)(16)(iii).

15 Final Rule § __.10(c)(16)(iv).

16 Although not all Family Vehicles and Customer Vehicles rely on Section 3(c)(1) or 3(c)(7) to avoid definition as an investment company under the Investment Company Act, the status of these vehicles under that Act can be unclear. As such, prior to the new exceptions, many banks treated these vehicles as covered funds.

17 Adopting Release at 109.

18 Adopting Release at 112.

small number of closely related persons to the family, but a *de minimis* amount of ownership can be held by other persons (including a banking entity) for certain purposes (*e.g.*, to achieve corporate separateness or to address bankruptcy concerns). A banking entity seeking to rely on this exclusion with respect to a Family Vehicle also must: (1) provide bona fide trust, fiduciary or advisory services to the Family Vehicle; (2) not directly or indirectly guarantee, assume or otherwise insure the Family Vehicle's obligations or performance; (3) comply with certain disclosure obligations that would be required if the Family Vehicle were a covered fund, subject to reasonable modification to prevent such disclosure from being misleading in light of the Family Vehicle's particular circumstances; (4) limit its ownership interest in the Family Vehicle (as indicated above); (5) comply with the requirement under § ___.14(b) that transactions between a banking entity and an affiliated covered fund be on terms and circumstances substantially the same as transactions with nonaffiliated companies and applicable requirements under § ___.15 relating to material conflicts of interest, high-risk investments, and safety and soundness when dealing with covered funds and (6) comply with limitations in the Board's Regulation W on a banking entity "bailing out" an affiliate by purchasing low quality assets, except that riskless principal transactions are permitted.

Similarly, a customer of a banking entity will sometimes seek to structure its investments through a vehicle (whether a "fund of one" or a vehicle available to the customer and its affiliates) that might rely on Section 3(c)(1) or (7) of the 1940 Act for a variety of legal, credit risk and accounting reasons. For example, a customer may form a Customer Vehicle and contribute assets to it as collateral to obtain bankruptcy-remote, non-recourse financing from a banking entity. In some jurisdictions, a customer may prefer to receive a note issued by a Customer Vehicle, which enters into a swap with a banking entity, rather than entering into a swap directly. In these and other similar structures, the Customer Vehicle is used for a single transaction for a customer or affiliated group of customers and not offered as a private fund to a broader set of investors as an investment product.

The Customer Vehicle exclusion is available if: (1) the customer for which the vehicle was created (together with its affiliates) owns all of the interests in the Customer Vehicle, subject to a permitted de minimis ownership interest held by the banking entity noted below; and (2) the banking entity and its affiliates: (i) maintain documentation indicating how the Customer Vehicle facilitates the customer's exposure; (ii) not directly or indirectly guarantee, assume or otherwise insure the Customer Vehicle's obligations or performance; (iii) comply with certain disclosure obligations that would be required if the Customer Vehicle were a covered fund, subject to reasonable modification to prevent such disclosure from being misleading in light of the Customer Vehicle's particular circumstances; (iv) limit its ownership interest in the Customer Vehicle in a manner similar to the requirements for Family Vehicles (as described above); (v) comply with the restrictions of § ___.14(b) on banking entities entering into transactions on terms substantially the same as those with nonaffiliated companies and applicable regulations of § ____.15 relating to material conflicts of interest, high-risk investments, and safety and soundness when dealing with covered funds; and (vi) comply with limitations in Regulation W that limit the risks of transactions with Customer Vehicles, including preventing a bank or banking entity from "bailing out" a Customer Vehicle by purchasing low-quality assets (except that riskless principal transactions are permitted).

Limitations on Relationships with a Covered Fund

The Final Rule relaxes the Volcker Rule Regulations' so-called "Super 23A" restrictions – which generally prohibit a banking entity from entering into transactions with any "related covered fund" – by exempting certain transactions between a banking entity and its related covered fund.[19] In adopting these exemptions, which track analogous

[19] A "related covered fund" of a banking entity is a covered fund for which the banking entity serves, directly or indirectly, as the investment manager, investment adviser, commodity trading adviser, or sponsor, or that the banking entity organizes or offers.

exemptions available to banks under Section 23A of the Federal Reserve Act and Regulation W, the Agencies observed that such transactions, subject to certain requirements and conditions, "generally do not present significant risk of loss and serve important public policy objectives."[20]

Specifically, the Final Rule permits a banking entity to enter into transactions that would be "exempt covered transactions" under Section 23A of the Federal Reserve Act and Regulation W, provided that the transactions satisfy all of the same conditions required by Regulation W. Such exempt covered transactions include (among others): entering into transactions secured by cash or U.S. government securities; purchasing an extension of credit subject to a repurchase agreement; and providing intraday extensions of credit (provided certain conditions are met). Because certain exempt transactions under Regulation W (including exemptions for affiliated transactions involving purchasing marketable securities, purchasing municipal securities and entering into riskless principal transactions[21]) apply only to transactions between a bank and its "securities affiliates," the availability of these exemptions in the Volcker Rule context is limited to transactions with a related covered fund that also meets the definition of "securities affiliate" (*i.e.*, a broker-dealer[22]). To address this, the Final Rule also establishes two stand-alone exemptions that do not require full compliance with Regulation W. The first permits a banking entity to enter into riskless principal transactions with a related covered fund. The second permits a banking entity to extend credit to or purchase assets from a related covered fund, subject to certain conditions.[23] Reliance on each of these Super 23A exemptions requires compliance with certain conflict of interest, high-risk, and safety and soundness restrictions.[24]

Ownership Interests

Investors in securitizations and lenders to loan funds had long worried that the definition of "ownership interest" in the Volcker Rule captured interests that had a market-standard creditor's remedy of removing the general partner or investment manager for cause outside of the context of an event of default. The Final Rule specifically carves out this removal right for "cause" from the definition of "ownership interest," as long as the removal pertains to a specified list of events – such as bankruptcy, material breach, or fraud by the general partner or manager (including a catch-all for "other similar events" that "are not solely related to the performance of the covered fund or the investment manager's exercise of investment discretion").[25] Further, the Final Rule adds a safe harbor for any "senior loan or senior debt interest" where: (1) the holder does not receive income or profits, but solely stated interest, fees and principal prior to

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The Final Rule provides that, notwithstanding their exclusion from the definition of covered fund, credit funds and venture capital funds remain subject to the Volcker Rule's Super 23A restrictions.

20 Adopting Release at 137.

21 The Final Rule defines a "riskless principal transaction" as "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." § __.10(d)(11).

22 *See* 12 CFR § 223.3(gg).

23 These conditions include: (i) the extension of credit or purchase of assets must be in the ordinary course of business in connection with payment transactions, settlement services, or futures, derivatives and securities clearing; (ii) any extension of credit must be repaid, sold or terminated within five business days; and (iii) a banking entity providing an extension of credit in reliance on exemption must meet certain requirements that apply to intraday extensions of credit under Regulation W (regardless of the duration of the extension of credit).

24 The Final Rule provides that any transaction or activity conducted in reliance on the exemptions must comply with the limitations set forth in § __.15 of the Volcker Rule Regulations.

25 Adopting Release at 151-52.

a stated maturity date; (2) the right to receive payments cannot be reduced based on losses from the underlying assets; and (3) the holders are not entitled to receive the underlying assets after the other interests have been redeemed. Notably (and significantly for investors in tranched investment structures such as CLOs), the Agencies affirmatively stated in the Adopting Release that the simple fact that a debt interest entitles its holder to receive an allocation of collections in accordance with a priority of payments or "waterfall" does *not* cause that interest to be considered an "ownership interest."[26]

Parallel Investments

The Final Rule also provides a welcome clarification with respect to the treatment of investments made by a banking entity alongside a covered fund. Although neither the text of the Volcker Rule nor the Volcker Rule Regulations expressly limit the ability of a banking entity sponsor of a covered fund to make such parallel or co-investments, the preamble to the adopting release for the Volcker Rule Regulations suggested, as an anti-evasion control, that the value of a banking entity sponsor's parallel investments should be included when determining the banking entity's compliance with the 3% limit on investments in a covered fund. The Final Rule clarifies that a banking entity's parallel or co-investments alongside the sponsored covered fund will not be subject to these limitations, so long as the investment is made in compliance with applicable laws and regulations, including applicable safety and soundness standards. The Agencies also indicated in the Adopting Release that they would not expect direct investments by the banking entity's directors and employees alongside the covered fund to be attributed to the banking entity as an investment in covered fund.[27]

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26 Adopting Release at 155.

27 Adopting Release at 166.

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