

# Client Alert

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August 3, 2017

## OCC Seeks Public Comment on the Volcker Rule

Section 13 of the Bank Holding Company Act (the “Volcker Rule”) and its implementing regulations (the “Implementing Regulations”) generally prohibit banking entities from engaging in proprietary trading and from investing in, sponsoring, or having certain relationships with covered funds.

On August 2, 2017, the Office of the Comptroller of the Currency (“OCC”) submitted to the *Federal Register* a notice requesting public comment on how the Implementing Regulations should be revised to better accomplish the purposes of the Volcker Rule while decreasing the compliance burden on banking entities and fostering economic growth (the “Notice”). The Notice also requests input concerning “how the existing rule could be implemented more effectively without revising the regulation.”<sup>1</sup>

The OCC is seeking public input on all aspects of the Implementing Regulations but specifically requested comment on four topics:

- (i) the scope of entities subject to the Implementing Regulations;
- (ii) the proprietary trading prohibition;
- (iii) the covered funds prohibition; and
- (iv) the compliance program and metric reporting requirements.

In order to support revisions to the Implementing Regulations, the Notice emphasizes that “it is especially important for those commenting to provide evidence demonstrating the nature and scope of the problems they identify and the likely efficacy of any solutions they propose.”<sup>2</sup> Although the OCC appears to be acting independently of the other four regulators that have adopted the Implementing Regulations,<sup>3</sup> the initiative may serve to kick-start a regulatory review process that could lead to a reduction in some of the burdens of the Volcker Rule, albeit within the constraints of the statutory language. The Notice, and other recent activity regarding the Volcker Rule by banking regulators, is also largely consistent with recommendations set forth in the report from the U.S. Department of the Treasury outlining the administration’s proposal for reforming regulations related to banks and credit unions.<sup>4</sup>

Comments will be due 45 days from the date of publication in the *Federal Register*. A more detailed discussion of the topics identified in the Notice follows.

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<sup>1</sup> The Notice clarifies that the OCC is not seeking comment on changes to the underlying Volcker statute. A copy of the Notice is available at: <https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf>. The OCC’s press release is available at: <https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-89.html>.

<sup>2</sup> In the Notice, the OCC also clarifies that it “recognizes that revisions to the current rule must be undertaken jointly by the OCC, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation and in consultation and coordination with the Securities and Exchange Commission and the Commodity Futures Trading Commission.”

<sup>3</sup> The other four regulators include the Board of Governors of the Federal Reserve System, the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Federal Deposit Insurance Corporation.

<sup>4</sup> The U.S. Department of the Treasury report is available at: [https://www.treasury.gov/press-center/press-releases/Documents/A Financial System.pdf](https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf).

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## SCOPE OF ENTITIES SUBJECT TO THE VOLCKER RULE

The Volcker Rule's prohibition on proprietary trading applies to any banking entity. The term "banking entity" is defined broadly to include any insured depository institution, any company that controls an insured depository institution, any company that is treated as a bank holding company for the purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any of the foregoing entities.<sup>5</sup>

As a result, according to the Notice, the Implementing Regulations apply to "many entities that may not pose systemic risk concerns, such as small, community banks engaged primarily in traditional banking activities and other banks that do not engage in the type of activities, or in activities that present the type of risk, that the Volcker Rule was designed to restrict." Although the Implementing Regulations contain tailored compliance program requirements designed to relieve regulatory burdens on smaller banking entities, the Notice remarks that "even determining whether an entity is eligible for the simplified program can pose a significant burden for small banks." The Notice also observes that the banking entity definition extends to funds that are deemed to be controlled by foreign banking organizations.<sup>6</sup>

The Notice solicits input on, among other things: (i) evidence that the scope of the Implementing Regulations is too broad; (ii) suggestions on revisions to the Implementing Regulations to narrow their application and reduce any unnecessary compliance burden; and (iii) ways to carve out foreign excluded funds "controlled" by banking entities.<sup>7</sup>

## PROPRIETARY TRADING PROHIBITION

The Implementing Regulations define "proprietary trading" as "engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments."<sup>8</sup> The Notice identifies two issues with the Implementing Regulations' definition of proprietary trading.

First, the term "trading account" is defined to include (among other things) an account that is used by a banking entity to purchase or sell financial instruments principally for certain enumerated purposes.<sup>9</sup> The Notice states that "[b]anking entities and commentators have asserted that [the purpose test] imposes a significant compliance burden because it requires determining the intent associated with each trade."

Second, the Implementing Regulations contain a presumption that the purchase or sale of a financial instrument is for a trading account if the banking entity "holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase."<sup>10</sup> The Notice states that banking entities have asserted that this presumption may capture transactions that are not the intended target of the Volcker Rule.

<sup>5</sup> 12 C.F.R. § 44.2(c)(1). Subsection 44.2(c)(2) contains certain exclusions from this definition. All citations herein are to regulations promulgated by the OCC.

<sup>6</sup> On July 21, 2017, the OCC, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation jointly released their Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act. The statement establishes a one-year moratorium on enforcement of the Volcker Rule against certain "qualifying foreign excluded funds." For additional information, please see our July 24, 2017 Client Alert, "Federal Banking Agencies Announce No-action Position on Certain Foreign Excluded Funds Under the Volcker Rule," available at: <https://media2.mofo.com/documents/170724-federal-agencies-foreign-funds-volcker.pdf>.

<sup>7</sup> See *id.* (discussing the recent one-year moratorium on enforcement against certain "qualifying foreign excluded funds").

<sup>8</sup> 12 C.F.R. § 44.3(a).

<sup>9</sup> These purposes are: (A) short-term resale; (B) benefitting from actual or expected short-term price movements; (C) realizing short-term arbitrage profits; or (D) hedging one or more positions resulting from the purchases or sales of financial instruments described in (A) through (C). 12 C.F.R. § 44.3(b)(1)(i).

<sup>10</sup> 12 C.F.R. § 44.3(b)(2).

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The Notice solicits input on, among other things: (i) whether the rebuttable presumption should be revised or eliminated or replaced with a reverse presumption; (ii) whether additional activities should be permitted under the proprietary trading provisions; and (iii) ways to simplify and streamline the existing exclusions and exemptions.

## COVERED FUNDS PROHIBITION

The Volcker Rule generally prohibits banking entities from holding or acquiring an ownership interest in, or sponsoring, any private equity fund or hedge fund. The Volcker Rule defines “hedge fund” and “private equity fund” as an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (the “Investment Company Act”) but for section 3(c)(1) or 3(c)(7) thereof, or such similar funds as the agencies may, by rule, determine.<sup>11</sup> The agencies defined the term “covered fund” in the Implementing Regulations by referencing sections 3(c)(1) and 3(c)(7) of the Investment Company Act and also by including certain commodity pools and foreign funds.<sup>12</sup>

The Implementing Regulations’ so-called “Super 23A” provision also implements the Volcker Rule’s limitations on relationships with private equity funds and hedge funds.<sup>13</sup>

The Notice solicits input on, among other things: (i) whether the covered fund definition is too broad; (ii) ways to narrow the covered fund definition; (iii) information regarding the effectiveness of the Super 23A provision; and (iv) whether there are any categories of transactions and relationships that should be permitted under the Super 23A provision.

## COMPLIANCE PROGRAM AND METRIC REPORTING REQUIREMENTS

The Implementing Regulations establish compliance program requirements based on the size, complexity, and type of activity conducted by a banking entity. According to the Notice, “banking entities have reported that the compliance program requirements in the [Implementing Regulations] present a compliance burden, especially for small institutions that are not engaged in significant levels of proprietary trading and covered fund activities.”

The Notice solicits input on, among other things: (i) evidence that the compliance program and metrics reporting requirements present a disproportionate or undue burden on banking entities; (ii) ways to revise the Implementing Regulations to reduce the burden associated with the compliance program and reporting requirements; and (iii) whether there are categories of entities for which compliance program requirements should be reduced or eliminated.

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<sup>11</sup> 12 U.S.C. § 1851(h)(2).

<sup>12</sup> 12 C.F.R. § 44.10(b).

<sup>13</sup> 12 C.F.R. § 44.14.

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