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GREAT FUND INSIGHTS

Final rule implementing amendments to the Volcker rule

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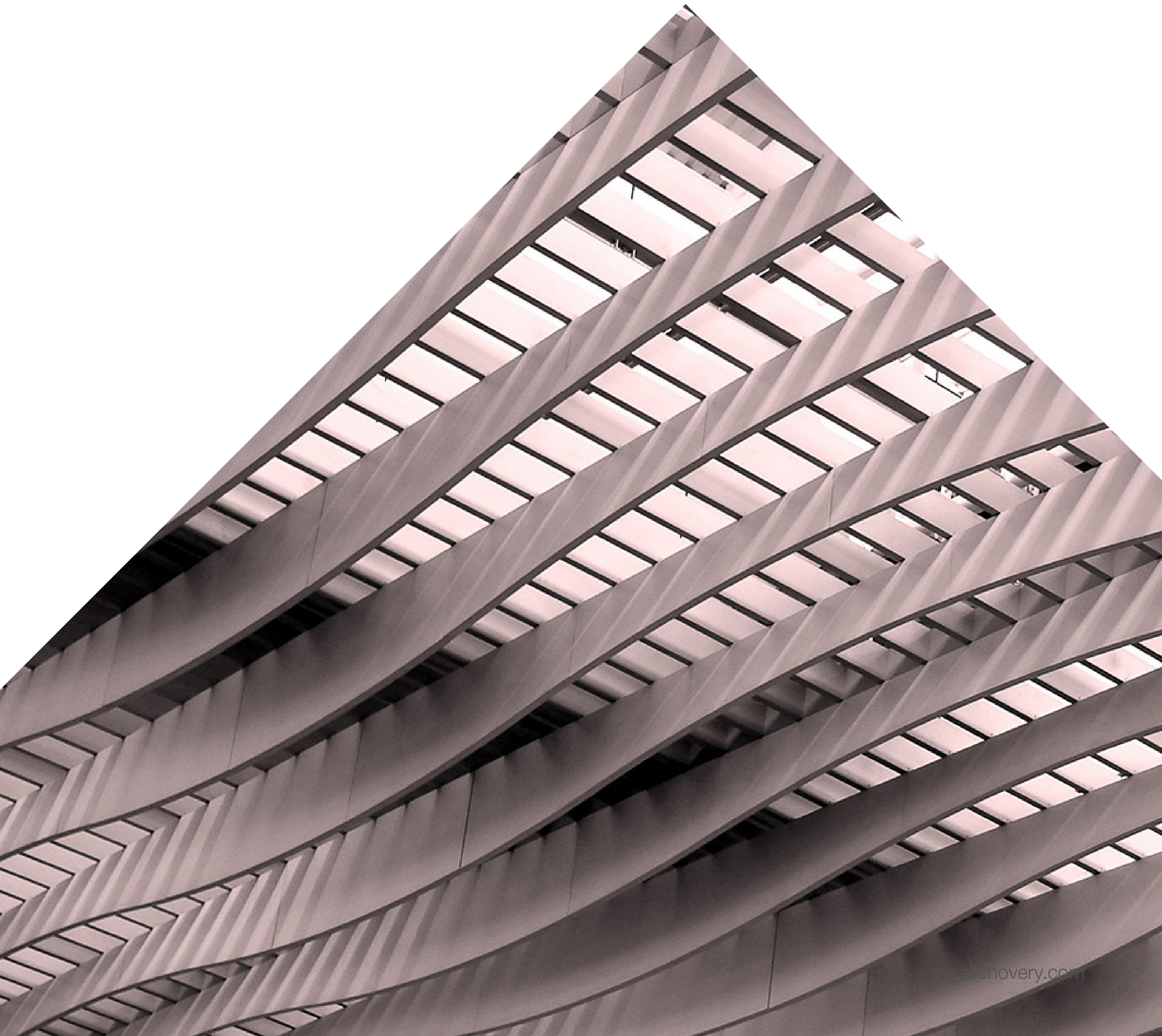

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Final rule implementing amendments to the Volcker rule

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission (the **SEC**) and the Commodity Futures Trading Commission (together, the **Agencies**), on June 25, 2020, promulgated a final rule (the **2020 Final Covered Funds Rule**) modifying and clarifying requirements related to the covered fund provisions of the existing rule (the **Volcker Regulations**) promulgated pursuant to Section 13 of the Bank Holding Company Act of 1956, as amended, 12 USC 1851 (the **BHC Act**). The Volcker Regulations are intended to prohibit "banking entities" from engaging in proprietary trading or certain relationships with hedge funds and private equity funds. The 2020 Final Covered Funds Rule follows a notice of proposed rulemaking published in February 2020 (the **2020 Proposed Rule**). [i]

The effective date of the 2020 Final Covered Funds Rule is October 1, 2020, although the Agencies do not believe an extended compliance or transition period is necessary because the 2020 Final Covered Funds Rule largely tailors the regulations implementing Section 13 of the BHC Act rather than increases compliance burdens.

The Volcker Regulations generally prohibit a "banking entity" from engaging in proprietary trading and from acquiring or retaining an ownership interest in, or sponsoring or having certain relationships with, a covered fund. In promulgating the 2020 Final Covered Funds Rule, the Agencies have not altered the definition of "covered fund," but rather have opted to, among other things:

(i) clarify and simplify compliance with the implementing regulations;

(ii) refine the extraterritorial application of Section 13 of the BHC Act; and

(iii) permit certain additional fund activities that the Agencies consider to not present the risks that Section 13 was intended to address.

The related changes codify many of the approaches already followed by the Agencies in practice. The Agencies have generally adopted the changes as proposed by the 2020 Proposed Rule. In particular, the 2020 Final Covered Funds Rule provides for:

Clarification to the Definition of "Ownership Interest"

The Volcker Regulations generally prohibit a banking entity from acquiring or retaining an "ownership interest" in covered funds, and require a banking entity that organizes and offers a covered fund to be subject to investment limits and capital deductions with respect to the banking entity's ownership interests in any such covered fund. In the 2020 Proposed Rule, the Agencies proposed amendments to the definition of "ownership interest" in order to address concerns from market participants that the current definition of "ownership interest" is overly broad. The Agencies largely adopted and further clarified the amendments proposed by the 2020 Proposed Rule, including (i) clarifying that a loan or debt interest with certain traditional creditor rights – including the right to remove an investment manager for "cause" – would not be an ownership interest and (ii) providing an express safe harbor to ensure that senior loans and senior debt interests do not constitute "ownership interests."

The right to participate in the removal of an investment manager for "cause" or participate in the selection of a replacement manager upon such removal is not an ownership interest.

The term "ownership interest" under the Volcker Regulations includes "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)." [ii]

[i] OCC, FRB, FDIC, CFTC, SEC, NPR, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 12120 (February 28, 2020).

[ii] 12 C.F.R. Part 248.10(d)(6)(i)(A).

Under the 2020 Proposed Rule, the Agencies proposed amendments to clarify the types of interests that would be considered within the scope of the definition of "ownership interest" by specifying that a creditor's 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, and that such rights would not be considered an "ownership interest" for this reason alone.

While commenters were generally supportive of such an amendment, there were concerns that the 2020 Proposed Rule did not address instances in which removal and replacement rights are provided to creditors in the **absence** of an event of default or acceleration event. Addressing these concerns, the Agencies make clear in the 2020 Final Covered Funds Rule that the right of a creditor to remove or replace an investment manager for cause or to nominate, or vote on a nominated, replacement manager outside of an event of default or acceleration event would not be considered an ownership interest for this reason alone.[iii]

For this purpose, "for cause" includes:

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

The 2020 Final Covered Funds Rule helps to pave the way for additional investment by banks of debt in collateralized loan obligations (**CLOs**), which debt often includes the right for holders to participate in, and vote on, the removal of a portfolio manager for "cause" and the selection of any applicable replacement manager. The clarification by the 2020 Final Covered Fund Rule that such right would no longer constitute an "ownership interest" removed the concern for banks that investing in CLO debt could constitute a prohibited investment under the Volcker Regulations. These changes may also prove to be beneficial by removing a regulatory hurdle to the ability of CLO managers to purchase certain non-loan assets in order to maximize recoveries in connection with a default or workout of a loan, particularly in light of a recent well-publicized trend among some opportunistic loan investors to shift recoveries into non-loan assets and equity rights precisely for the purpose of limiting the ability of CLOs in which debt is held by banking entities to participate in such recoveries (although this tactic is also addressed elsewhere in the 2020 Final Covered Funds Rule).

Bona Fide senior loan or other senior debt interests benefit from a safe harbor and thus should not be deemed to be ownership interests.

Another concern expressed by the commenters on the definition of "ownership interest" was that some ordinary debt interests could be construed as ownership interests. To address this concern, the Agencies proposed a safe harbor from the definition of ownership interest for bona fide senior loan or senior debt interests that meet certain characteristics. The Agencies generally adopted the proposals in the 2020 Proposed Rule, with minor changes clarifying that the safe harbor is available to bona fide senior loan and senior debt interests where the contractual principal payments are due over the life of the instrument, provided that the total amount of principal required to be repaid over the life of the instrument does not change.

After the changes effected by the 2020 Final Covered Fund Rule come into effect, any senior loan or senior debt interest with the following characteristics will not be considered an ownership interest:

(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:

[iii] The 2020 Final Covered Fund Rule continues to exclude any removal or replacement rights reflecting a creditor's right to exercise remedies after the occurrence of an event of default or an acceleration event from being deemed an ownership interest.

(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).

Some commenters expressed the concern that, in the case of securitizations, the restriction on the right to receive "a share of the income, gains, or profits of the covered fund" may cause an interest in a securitization to be an ownership interest. In response to these concerns, the Agencies also clarified that a debt interest in a covered fund would not be viewed as an ownership interest solely because the interest is entitled to receive an allocation of collections from the covered fund's underlying assets in accordance with a contractual priority of payments or waterfall so long as such amounts are limited to fixed principal and interest determined on a fixed or typical index floating rate.

While the safe harbor for senior loans and senior debt interests is beneficial to CLOs and other securitizations by clarifying that the exemption to "ownership interest" covers not only the highest rated debt classes, but also other debt classes, CLO debt investors do not need to rely on this safe harbor. As discussed above, debt investors, including banks, no longer need to be concerned that their investment in CLO debt would be construed as an "ownership interest" since the 2020 Final Covered Funds Rule has made clear that "ownership interest" does not include the right to removal and replacement of the CLO manager.

Expansion of the Loan Securitization Exclusion

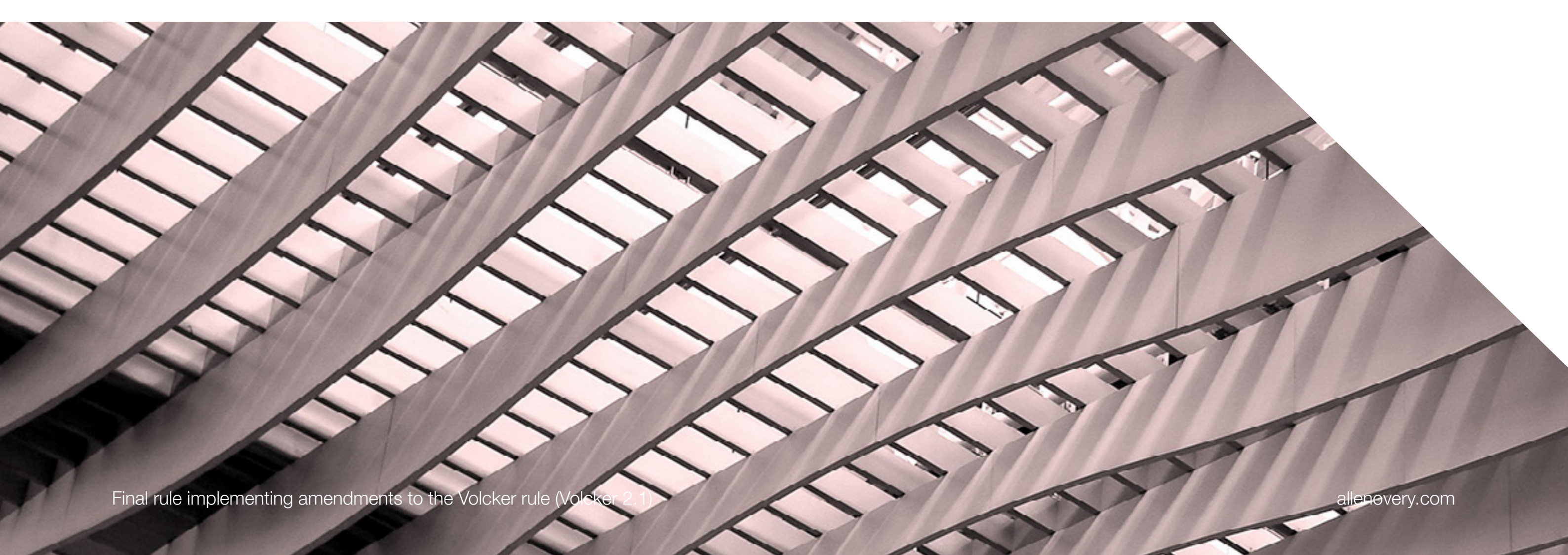
In response to concerns by market participants that the Volcker Regulations unnecessarily restricted their ability to utilize the loan securitization exclusion [iv], the Agencies sought in the 2020 Proposed Rule to (i) codify the guidance on servicing assets and "cash equivalents" provided in the Loan Securitization Servicing FAQ [v], and (ii) permit a loan securitization vehicle to hold non-loan assets not exceeding 5% of the vehicle's assets (the **5% bucket**). The 2020 Final Covered Funds Rule adopted the codification of servicing assets and "cash equivalents" provided in the Loan Securitization Servicing FAQ as proposed, but limited the 5% bucket to be applicable to debt securities (excluding asset-backed securities and convertible securities) only.

Guidance in the Loan Securitization FAQ on servicing assets and "cash equivalents" is codified.

The Agencies have largely codified the Loan Securitization Servicing FAQ with respect to servicing assets and "cash equivalents." Thus, issuers may hold rights or other servicing assets that are designed to facilitate the servicing of the underlying loans or the distribution of proceeds from those loans to holders of the securitization's asset-backed securities ("servicing assets"). Servicing assets may include assets other than securities, but any securities must be otherwise permitted under the loan securitization exclusion.

[iv] 12 C.F.R. Part 248.10(c)(8).

[v] Loan Securitization Servicing FAQ. See https://www.fdic.gov/regulations/reform/volcker/faq/loan-securitization.pdf. This FAQ clarifies that, if a servicing asset is a security, it must be a permitted security under the rule. Permitted securities under this section include cash equivalents and securities received in lieu of debts previously contracted.



The loan securitization exclusion also permits issuers to hold certain types of contractual rights or assets related to the contractual rights or assets related to the loans underlying the securitization, including "cash equivalents." "Cash equivalents" are limited to 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. Consistent with the 2020 Proposed Rule, the Agencies are not requiring that "cash equivalents" be "short term" interests.

The loan securitization exclusion now permits a limited "5% bucket" of certain debt securities.

The Volcker Regulations do not permit a vehicle relying on the loan securitization exclusion to hold any securities unless specifically permitted, including securities that were either "cash equivalents" or securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities. The 2020 Proposed Rule, reflecting the Agencies' stated intent, expands the loan securitization exclusion to permit a loan securitization vehicle to hold up to 5% of the vehicle's total assets in non-loan assets. The Agencies observed that allowing excluded loan securitizations to hold limited amounts of non-loan assets would improve the ability of banking entities to sell or securitize loans.

The Agencies have retained the 5% bucket concept in the 2020 Final Covered Funds Rule, but – in an effort to minimize the potential for banking entities to use this exclusion to engage in impermissible activities or take on excessive risk – have also limited holdings in such 5% bucket to debt securities (excluding asset-backed securities and convertible securities), as opposed to any non-loan assets. The Agencies require that the 5% limit be calculated based on the par value of the assets and the debt securities at the most recent time of acquisition of the assets, except in cases where the loan securitization vehicle is obligated to use fair market value in order to calculate other limitations under the transaction documents and the vehicle's valuation methodology values similarly situated assets consistently.

In practical terms, the 5% bucket expressly permits CLO issuers to acquire bonds in limited quantities as part of their eligible investments, something currently prohibited in most CLO transactions. However, since CLO debt would no longer be construed as an "ownership interest" prohibited under the Volcker Regulations (as discussed above), CLO issuers can potentially purchase and hold bonds in a greater capacity than 5% as long as commercially acceptable by their investors.

Modification of Certain Restrictions on Foreign Public Funds

In the 2020 Proposed Rule, the Agencies proposed amendments simplifying the exclusion for foreign public funds for the dual purposes of addressing concerns that certain conditions did not appropriately address structural issues applicable to foreign public funds and ensuring consistent treatment of foreign public funds and U.S. registered investment companies (**RICs**). The Agencies have adopted the proposals in the 2020 Proposed Rule with minor modifications by:

(1) eliminating the requirement under the Volcker Regulations that the foreign public fund be authorized to be offered and sold to retail investors in the fund's home jurisdiction and the requirement that ownership interests be sold predominantly through public offerings, and instead requiring that the fund be authorized to offer and sell ownership interests, and such interests are offered and sold, through one or more public offerings;

(2) modifying the definition of "public offering" to require that the distribution is subject to substantive disclosure and retail investor protection laws or regulations, to help ensure that funds qualifying for this exclusion are subject to governance regimes similar to those applicable to RICs;

(3) reducing the level of unaffiliated ownership of a foreign public fund required by U.S. banking entities relying on the foreign funds exclusion by replacing the requirement that a fund be "predominantly" sold to persons other than its U.S. banking entity sponsor and associated parties (which the Agencies stated would be 85% or more under the Volcker Regulations) by a requirement that 75% of the fund's interests be sold to persons other than the U.S. banking entity sponsor and associated parties;

(4) eliminating for a banking entity that does not serve as the fund's investment manager, investment adviser, commodity trading advisor, commodity pool operator or sponsor, the burden of determining that the distribution of the foreign fund complied "with all applicable requirements in the jurisdiction in which such distribution is being made," 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; and

(5) simplifying the requirements of tracking the sale of ownership interests to employees and their immediate family members, by eliminating 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).

Relief with Respect to Restrictions on Activities of Qualifying Foreign Excluded Funds

In the 2020 Proposed Rule, the Agencies proposed to codify relief from the Volcker Regulations that was first granted in individual cases to eligible foreign funds in 2017, in order to address concerns about the possible unintended consequences and extraterritorial impact of Section 13 of the BHC Act and the rule for foreign excluded funds under the Volcker Regulations. Under the Volcker Regulations as in effect prior to the implementation of the 2020 Final Covered Funds Rule, it is possible that certain foreign excluded funds could be treated as if they were "banking entities" and separately subject to the prohibitions under the Volcker Regulations. Acknowledging this possibility, the Agencies stated beginning in 2017 that they would not propose to take action against a foreign banking entity based on attribution of the activities and investments of a qualifying foreign excluded fund to the foreign banking entity, or against a qualifying foreign excluded fund as a banking entity, in each case where the foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, the qualifying foreign excluded fund would meet the requirements for permitted covered fund activities and investments solely outside the United States.

Clarifying the anti-evasion provisions and compliance program requirements, the Agencies confirmed in the 2020 Final Covered Funds Rule that a qualifying foreign excluded fund would not be subject to (i) the proprietary trading restrictions in Section __.3(a) of the Volcker Regulations, (ii) the covered fund restrictions in Section __.10(a) of the Volcker Regulations, or (iii) the compliance program and reporting and documentation requirements under Section __.20 of the Volcker Regulations.

A "qualifying foreign excluded fund" means, with respect to a foreign banking entity, an entity that would be a covered fund if organized or established in the United States, 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, to the extent that it:

(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 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 criteria:

  (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 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 12 C.F.R. Part 248.13(b);

(3) is established and operated as part of a bona fide asset management business; and

(4) 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 the Volcker Regulations.

Exclusion of Certain Credit Funds from the Definition of "Covered Fund"

The 2020 Proposed Rule included an exclusion from the definition of "covered fund" for certain credit funds in order to more directly align the regulation with the purpose of Section 13 of the BHC Act. A "credit fund" is a fund that makes loans [vi], invests in debt or otherwise extends the type of credit that banking entities may directly provide under applicable law. With minor modifications, the Agencies generally adopted the credit fund exclusion.

As amended by the Agencies in the 2020 Final Covered Funds Rule, any issuer that satisfies the following asset and activity limitations may qualify as a permitted "credit fund":

(1) the issuer's assets consist solely of:

  (i) loans;

  (ii) debt instruments permissible for the banking entity relying on the exclusion to hold directly;

  (iii) related rights and instruments or other assets that are related or incidental to acquiring, holding, servicing or selling loans or debt instruments, provided that (i) if any such assets is a security, such security is either a cash equivalent, a security received in lieu of debts previously contracted, or an equity security (or right to acquire an equity security) received on customary terms in connection with permitted loans and debt instruments, and (ii) no such assets may be commodity forward contracts or any derivatives;

  (iv) certain interest rate or foreign exchange derivatives that reduce the interest rate or foreign exchange risks related to the permitted assets of the credit fund; and

(2) the issuer does not (i) engage in activities that would constitute proprietary trading if it were a banking entity, or (ii) issue asset-backed securities.

[vi] "Loans" is defined in Section __.2(t) of the Volcker Regulations to mean "any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative."

A banking entity seeking to rely on the credit fund exclusion may not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the credit fund or of any entity to which the credit fund extends credit or invests, and any assets that the credit fund holds must be permissible for the banking entity to acquire and hold directly under applicable law. Additionally, the banking entity's investment in and relationships with the credit fund must comply with the material conflicts of interest rules and safety and soundness limitations of Section __.15 of the Volcker Regulations.

A banking entity that is a sponsor, investment adviser or commodity trading advisor to a credit fund (i) is subject to additional disclosure obligations, (ii) must comply with the "Super 23A" restrictions under Section __.14 of the Volcker Regulations as though the credit fund were a covered fund (except that the banking entity may acquire and retain any ownership interests in the credit fund) and (iii) must conduct its activities with the credit fund in compliance with and subject to all applicable federal banking law and regulations.

Of note, the credit fund exclusion is not available to issuers of asset-backed securities, who may be able to rely on the loan securitization exclusion. The credit fund exclusion may, however, be available to issuers who could not previously rely on the loan securitization exclusion because they did not issue asset-backed securities.

Exclusion of Certain Qualifying Venture Capital Funds from the Definition of "Covered Fund"

In the 2020 Proposed Rule, the Agencies observed that, contemporaneous with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, multiple Members of Congress made statements indicating that Section 13 of the BHC Act should not restrict the activities of venture capital funds, in particular reflecting the view that such funds neither presented the same concerns as those associated with other private funds, and that they can promote the public interest and job creation. Moreover, the Financial Stability Oversight Council Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (Jan. 18, 2011) (**FSOC Report**),[vii] characterized the exclusion of venture capital funds from the definition of "covered fund" as a "significant issue," and it was noted that several commenters recommended excluding venture capital funds because the nature of venture capital funds is fundamentally different from such other funds and because they promote innovation. Accordingly, the Agencies proposed the addition of an exclusion from the definition of "covered funds" for certain "qualifying venture capital funds" that would allow banking entities to fully engage in this type of investment activity in areas where such financing may not be readily available, while also allowing banking entities to allocate resources to a more diverse array of long-term investments. The Agencies have largely adopted the proposed qualifying venture capital fund exclusion, with certain adjustments.

The qualifying venture capital fund exclusion provisions of the 2020 Final Covered Fund Rule leverage the SEC rules to specify what constitutes a venture capital fund. A "qualifying venture capital fund" is an issuer that is a venture capital fund as defined in SEC Rule 203(l)-1 (**Rule 203(l)-1**),[viii] under the U.S. Investment Advisers Act of 1940, as amended.

Under Rule 203(l)-1, a "venture capital fund" is any private fund that "(i) represents to investors and potential investors that it pursues a venture capital strategy, (ii) 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, (iii) does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the private fund's aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee by the private fund of a qualifying portfolio company's obligations up to the amount of the value of the private fund's investment in the qualifying portfolio company is not subject to the 120 calendar day limit, (iv) 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 (v) is not registered under Section 8 of the Investment Company Act of 1940[…], and has not elected to be treated as a business development company pursuant to Section 54 of that Act[…]." [ix] Rule 203(l)-1 does not define the term "venture capital strategy," although the SEC's related proposed rulemaking characterized a "venture capital fund" as providing "operating capital to companies in the early stages of their development with the goal of eventually either selling the company or taking it public." [x]

As with the credit fund exclusion, a banking entity seeking to rely on the qualifying venture capital funds exclusion may not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the qualifying venture capital fund, and must comply with the material conflicts of interest rules and safety and soundness limitations of Section __.15 of the Volcker Regulations with respect to its ownership interest in or relationship with the qualifying venture capital fund.

[vii] Avail. at https://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf.

[viii] 17 C.F.R 275.203(l)-1.

[ix] 17 C.F.R. 275.203(l)-1(a).

[x] SEC, NPR, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 75 Fed. Reg. 77190, 77193 (December 10, 2010).

A banking entity can sponsor, act as investment adviser or commodity trading advisor to the qualifying venture capital fund, but is subject to additional disclosures obligations, must comply with the "Super 23A" restrictions under Section __.14 of the Volcker Regulations as though the qualifying venture capital fund were a covered fund (except that the banking entity may acquire and retain any ownership interests in the qualifying venture capital fund), and must ensure that 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 activities directly.

Modification of Super 23A Restrictions to Permit Certain Transactions

Under the Volcker Regulations, a banking entity is prohibited from entering into certain "covered transactions," as defined in Section 23A of the Federal Reserve Act, 12 USC 371c (**Section 23A**, which governs the terms of "covered transactions" between banks and certain non-bank affiliates), with a covered fund if the banking entity organizes and offers such covered fund or holds a covered fund interest in connection with Section __.11 of the Volcker Regulations, sponsors such covered fund, or serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor or sponsor to such covered fund (a **Covered Banking Entity**).

"Covered transactions" refers to transactions such as extensions of credit by the banking entity for the benefit of the covered fund, purchases of assets by the banking entity from the covered fund and certain other kinds of funding arrangements. While the Volcker Regulations do not include any of the exemptions or qualitative exceptions that enable limited "covered transactions" under Section 23A or Regulation W, [xi] the 2020 Proposed Rule reflected the Agencies' proposal to permit some of the exempt covered transactions set forth in Section 23A or Regulation W, and their belief that the rationale that supports the exemptions with respect to member banks also supports exempting such transactions from the prohibition on covered transactions between a banking entity and related covered funds under Section 12 USC 1851(f)(1), so long as they are conducted on arm's length terms in accordance with Section 23B of the Federal Reserve Act, 12 USC 371c-1. In particular, the 2020 Final Covered Funds Rule will permit the following kinds of transactions:

(1) giving credit for uncollected items in the ordinary course;

(2) transactions secured by cash or U.S. government securities;

(3) engaging in a credit transaction to the extent that the transaction is and remains secured by:

(i) obligations of the United States or its agencies; or

(ii) obligations fully guaranteed by the United States or its agencies as to principal and interest;

(4) purchasing certain liquid assets having a readily identifiable and publicly available market quotation and purchased at or below the asset's current market quotation;

(5) purchasing certain marketable securities if the security has a "ready market," is widely quoted and the security is not a low-quality asset;

(6) entering into a riskless principal transaction with a related covered fund; and

(7) entering into certain short-term extensions of credit with a related covered fund that are related to payment, clearing and settlement activities.

[xi] The Federal Reserve's regulation with respect to Section 23A, 12 C.F.R. Part 223.

Additional Revisions

The 2020 Final Covered Funds Rule adopts other proposals in the 2020 Proposed Rule substantially as proposed and with minimal changes, including: (i) clarifying the small business investment companies and public welfare investment funds exclusion; (ii) creating new exclusions for family wealth management vehicles and customer facilitation vehicles; (iii) simplifying a banking entity's ability to comply with aggregate fund limit and covered fund deduction provisions; and (iv) clarifying ambiguities to parallel and co-investment limits.

Finally, the 2020 Final Covered Funds Rule also amends the Volcker Regulations to clarify the manner and method of calculation for a permitted investment in a covered fund for regulatory capital purposes.

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