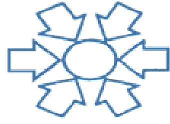

FedFin Client Report

Thursday, January 30, 2020

Volcker Rule Rewrite Sparks Renewed Controversy, Bank-Ownership Restraints are Liberalized

Client Report: **TAKEOVER9**

Executive Summary

As anticipated, the FRB and FDIC today approved a controversial proposal joined by the OCC, SEC, and CFTC to expand the covered funds banks may own or support under the Volcker Rule. Also as anticipated, FRB Gov. Brainard and FDIC Director Gruenberg opposed changes to the covered-fund rules that would allow banks to have larger stakes in credit funds and venture capital (VC) entities on grounds that this is contrary to the Volcker Rule, Congressional intent, and hard crisis experience. Mr. Gruenberg also emphasized risks to insured depositories due to liberalization and even repeal of "Super 23A" provisions. Chairman Powell and the rest of the Board as well as FDIC Chair McWilliams and Comptroller Otting supported the NPR, saying it adds simplicity and clarity, with Ms. Brainard and Mr. Gruenberg agreeing with this only with regard to the proposed treatment of foreign banks and extraterritoriality.

The Fed's takeover final rule is very similar to the NPR (see FSM Report **TAKEOVER8**). Although it was uncontroversial, it does more than simplify and clarify current control thresholds. As a result, it will not only provide clarity to potential business alliances, but also expand the integration of banks with fintech and other nonbanking companies.

FedFin will shortly provide clients with in-depth analyses of both the covered-fund NPR and takeover final rule.

Analysis

1. *Covered Funds*

This NPR would:

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- reduce U.S. extraterritorial impact by enacting in rule a longstanding series of exemptions provided to foreign banks;
- allow banking entities to enter into transactions with most permissible funds that are otherwise permissible under Section 23A (e.g., extensions of credit, payment-settlement-and-clearing services). Banks could also guarantee related funds;
- simplify the requirements related to public funds;
- expand permissible funds to include loan-securitization funds and permissible servicing assets and increase authority to take risks and engage in certain transactions. As noted, Super 23A would be repealed for these funds;
- permit new funds, including credit funds not eligible under the loan-securitization exemption, where bank guarantees would not be allowed and Super 23A would continue to apply. VC funds would also be allowed as long as the banking entity could directly engage (i.e., via a merchant bank) in VC-fund activities, retaining Super 23A and nonguaranteed provisions. Comment is sought on whether permissible VCs should be more tightly restricted (i.e., only to those investing in small companies). Family wealth offices and customer-facilitation funds would also be allowed; and
- liberalize the criteria for ownership interests and other provisions in the current rule. The NPR for example would permit higher-risk assets in loan-securitization funds.

Comment is due by April 1.

As noted, Gov. Brainard opposed the NPR, strongly disagreeing with statements by the rest of the Board and staff that it is consistent with Congressional intent in part by noting that Congressional revisions to law did not include these changes. She specifically cited credit and VC funds as highly problematic, noting crisis experience and the rationale in the current rule to buttress her point. New authority to permit synthetic funds would, she said, also heighten risk by creating incentives for banks to bail out funds as was done during the crisis.

Director Gruenberg echoed Ms. Brainard's concerns. However, reflecting the FDIC's role protecting insured depositories, his statement focuses in particular on Section 23A and notes numerous strong objections to repealing or revising the Super 23A requirements.

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2. Takeover Final Rule

Key features of the final rule versus the NPR include:

- tiered presumptions of control, changing the proposal to look only at the position of the controlling company and simplified control caps;
- a tighter standard for terminating control;
- closer conformance to accounting standards;
- exclusion of a special standard for SEC-registered investment companies; and
- various changes to calculation methodologies.

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