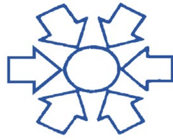

Venture-Capital Investment Restriction

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Impact Assessment

- A little-noticed OCC action signals a sharp change in agency policy towards controversial, non-traditional activities.
- The uncompromising enforcement warnings related to passive VC investments may extend to others under the covered-fund rule, suggesting the need for near-term review of current exposures ahead of supervisory assessment.
- OCC reinstatement of personal liability for national-bank directors adds a new element of governance risk in certain arenas.

Overview

The OCC is "clarifying," but also in many respects rescinding one aspect of controversial 2020 rules expanding the "covered funds" under which banks may make equity investments as provided by the Volcker Rule.[1] Although the bulletin doing so is very brief, it is also decisive: regardless of the extent to which a venture-capital (VC) investment is permitted under the covered-fund rule, it is barred for national banks and other entities under OCC jurisdiction unless it fits into other, narrower authorizing standards. These do not provide many of the additional liberalizations provided in the earlier rule for newly-permissible funds, meaning that national banks may not now

[1] See **COVEREDFUNDS2**, *Financial Services Management*, July 8, 2020.

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generally engage in passive VC investing and cannot garner some of the funding and operational flexibility also granted by the earlier standard.

Impact

Although little-noticed and applicable only to a few large organizations, this action continues Acting Comptroller Hsu's redesign of an array of controversial actions taken by his agency during the Trump Administration.[2] It remains to be seen if the Federal Reserve also reconsiders its own controversial actions under Vice Chairman Quarles and, should it do so, the extent to which this alters the balance of numerous similarly-disputed inter-agency standards similar to the covered-fund rule now implicitly revised by the OCC. Even if the Fed does not do so and/or the FDIC remains at least for a time committed to past action, it seems clear that federally-chartered institutions will need carefully to consider actions that press the boundaries of prior rules if they wish to avoid questioning by their OCC examiners or perhaps even enforcement action.

Although short (see below), the OCC's bulletin is extraordinarily direct, warning national banks that passive VC investments are not only generally impermissible but that, if these are made outside certain limited exceptions, the bank may be subject to costly enforcement action and directors could be required to reimburse the bank for any loss.

Direct reach to bank (but not BHC) directors is a longstanding provision in OCC rules designed at the time for smaller organizations in which there were often many conflicts between the commercial businesses controlled by bank directors and the bank's lending and investment activities. The national banks likely to have passive VC investments believed appropriate under the covered-fund rule are generally the largest organizations in which the concept of personal liability for bank directors has faded from governance considerations. With this bulletin, the OCC has forcefully reminded national banks not only of risks related to VC investments, but also to any others that might be questionable under the broader covered-fund rule. National banks may thus wish to review their direct investments and reassess their permissibility.

The scope of this action and its potentially broad implications stems from the difference between the OCC's view now and the underlying covered-fund rule which stated that passive VC investments were generally permissible. Promulgated by the OCC along with the FRB, FDIC, SEC, and CFTC, the rule expressly revised prior covered-fund standards to include VC funds on grounds that these were less risky than the hedge or private-equity funds Congress clearly meant to cover in the Volcker Rule's statutory language.[3] The agencies also concluded that VC funds advance capital formation and other public-policy objectives. The OCC bulletin does not address either the definition of VC funds or other conclusions related to them, simply reversing this provision when it comes to national banks due to the OCC's view now that they are unduly risky.

[2] See for example: **CRYPTO22**, *Financial Services Management*, December 1, 2021; **PREEMPT35**, *Financial Services Management*, November 2, 2020, and Client Report **CRA28**, May 26, 2020.

[3] See **PROPTRADE4**, *Financial Services Management*, March 8, 2021.

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What's Next

The OCC issued this bulletin on November 23. It is effective immediately, perhaps creating contractual and governance challenges for national banks with stakes in this sector.

Analysis

The actual bulletin is very brief, stating simply that:

- Banks under the OCC may generally not make passive VC investments regardless of the covered-fund rule.

- Exceptions to this blanket ban are cases in which such an investment is qualified under the agency's rules for public-welfare activities or small-business investment companies (SBICs).

- Banks that make passive VC investments must determine if the investment is permissible and "appropriate" for the bank as required under rules governing all national-bank investments. Banks that make inappropriate investments and their affiliated parties may be subject to enforcement actions that may include civil money penalties and directors may be personally liable for any investment losses. The bulletin does not address which affiliated parties or arrangements are of most concern, but these likely include those in which a national bank's operating subsidiary engages in VC activities deemed permissible due to the nature of the investment.

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