

Applicability of the Restrictions in Section 13(f) of the BHC Act

20. When does a banking entity become subject to the restrictions of section 13(f) and section 351.14 of the final rule with respect to a covered transaction with a covered fund? What about existing covered transactions?

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Section 13(f) of the BHC Act provides that no banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund (“covered fund”), or that organizes and offers a covered fund pursuant to section 13(d)(1)(G), and no affiliate of such entity, may enter into a transaction with the fund, or with any other covered fund that is controlled by such fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c) (“covered transaction”), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.¹ Section 351.14 of the final rule implements this statutory restriction.²

The statute gave banking entities a conformance period until July 21, 2014 to comply with the requirements of the Volcker Rule, and the Board extended this period by one year at the time of issuance of the final rule until July 21, 2015.³ As a general matter, on or after July 21, 2015, a banking entity may not enter into a covered transaction with a covered fund where the banking entity serves as investment manager, investment adviser, or sponsor to the covered fund or relies on the exemption in section 13(d)(1)(G). Staffs of the agencies believe that this restriction would apply to any increase in the amount of, extension of the maturity of, or adjustment to the interest-rate⁴ or other material term of, an existing extension of credit.⁵ In addition, with respect to any existing covered transaction, a banking entity should evaluate whether the transaction guarantees, assumes or otherwise insures the obligations or performance of the covered fund (or of any covered fund in which such covered fund invests) as prohibited by section 351.11(a)(5) of the final rule.⁶

The conformance period for legacy investments in and relationships with a covered fund (i.e., investments made and relationships entered into by a banking entity prior to December 31, 2013) currently ends on July 21, 2016.⁷ Staffs of the Agencies would expect a banking entity to engage in good-faith efforts during the conformance period to ensure that its investments in and relationships with legacy covered funds conform to section 351.14 of the final rule by the end of the applicable conformance period.⁸

¹ See 12 U.S.C. 1851(f).

² See 12 CFR 351.14(a).

³ See 12 U.S.C. 1851(c)(2); see also Board Order Approving Extension of Conformance Period (Dec. 10. 2013), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf>.

⁴ A floating-rate loan does not become a new covered transaction whenever the interest rate changes as a result of an increase or decrease in the index rate. If the banking entity and the borrower, however, amend the loan agreement to change the interest rate term, for example, from “LIBOR plus 100 basis points” to “LIBOR plus 150 basis points,” or from reference to the LIBOR index to the banking entity’s prime rate, the parties have engaged in a new covered transaction. See, e.g., Transactions Between Member Banks and Their Affiliates, 67 FR 76,560, 76,570 n.67.

⁵ This is based on the definition of “extension of credit” under the Board’s Regulation W promulgated under the Federal Reserve Act. See, e.g., 12 CFR 223.3(o)(5).

⁶ A banking entity must be in conformance with the requirements of the final rule, including as applicable the requirements of section 13(d)(1)(G), with respect to non-legacy covered funds (i.e., a covered fund which a banking entity sponsored or invested in after December 31, 2013) following July 21, 2015.

⁷ The Board granted banking entities until July 21, 2016, to conform investments in and relationships with covered funds that were in place prior to December 31, 2013, and announced its intention to act next year to grant banking entities until July 21, 2017, to conform investments in and relationships with legacy covered funds. See Board Order Approving Extension of

Conformance Period under Section 13 of the Bank Holding Company Act (December 18 2014) (hereinafter "Board's Conformance Period Order"), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20141218a.htm>.

⁸ See Board's Conformance Period Order.