



FINANCIAL REGULATORY REFORMS UPDATE

Title VI — Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

- **Commercial Firm Ownership of Limited Purpose Banks.** A three-year moratorium applies to the formation of new industrial bank, credit card bank and trust company charters and changes in control of existing industrial bank, credit card bank and trust company charters.
- **Intermediate Savings and Loan Holding Companies.** Grandfathered unitary savings and loan holding companies may be required to establish an intermediate savings and loan holding company structure over their savings association and most of their other financial activities. If grandfathered unitary savings and loan holding companies are required to do so, such companies themselves cease to be savings and loan holding companies.
- **Volcker Rule.** Depository institutions and their affiliates are prohibited from engaging in proprietary trading activities and investing in or sponsoring hedge funds or private equity funds. Such entities must dispose of prohibited investments or relationships within two years after the Volcker Rule requirements become effective, subject to up to three possible one-year extensions. An additional extension of up to five years may be granted by the Federal Reserve Board to the extent necessary in the case of an entity that is subject to a contractual obligation that was in effect on May 1, 2010 regarding an investment in or capital commitment to an illiquid fund. Several exceptions to the general prohibitions apply, including with respect to risk-mitigating hedging activities and trading conducted on behalf of customers. Additionally, a banking entity that organizes and offers a hedge fund or private equity fund may make and retain an initial investment if, within one year after establishment of the fund, the investment is reduced to 3% or less of total ownership interests and is immaterial to the banking entity (the maximum of all such investments must be 3% or less of the banking entity's Tier 1 capital). The Federal Reserve Board may extend the one-year period for two additional years.
- **Concentration Limits.** Depository institution mergers and acquisitions are prohibited if they result in a greater than 10% concentration of U.S. deposits in a single holding company or institution. Also, financial company mergers and acquisitions are prohibited if the total consolidated liabilities of the acquiring financial company upon consummation of the transaction would exceed 10% of the aggregate consolidated liabilities of all financial companies. Financial companies include depository institutions, companies that control them and nonbank financial companies supervised by the Federal Reserve Board under Title I of the Act.

Commercial Firm Ownership of Limited Purpose Banks

- *Moratorium on New Limited Purpose Banks.* A three-year moratorium applies to the FDIC's approval of deposit insurance applications received after November 23, 2009 by industrial banks, credit card banks or trust companies that are directly or indirectly owned by a commercial firm.
- *Moratorium on Commercial Firm Acquisitions of Limited Purpose Banks.* A three-year moratorium applies to changes in control that would result in a commercial firm acquiring direct or indirect control of an industrial bank, credit card bank or trust company, unless the change in control involves an institution in danger of default, involves a commercial firm engaging in a bona fide merger or whole acquisition of the commercial firm parent of the institution or results from an acquisition of voting shares of a publicly traded company that controls an industrial bank, credit card bank or trust company, if, after the acquisition, the acquiring shareholder (or group of shareholders acting in concert) holds less than 25% of any class of the voting shares of the company. For each exception, the commercial firm that is acquiring control also must obtain all required regulatory approvals.
- *Commercial Firm Definition.* A company is a "commercial firm" if its consolidated annual gross revenues derived from activities that are financial in nature (as defined in Section 4(k) of the BHCA), including from insured depository institutions that it controls, represent less than 15% of the consolidated annual gross revenues of the company.
- *GAO Study of BHCA Exemptions.* The U.S. Government Accountability Office ("GAO") is directed to carry out a study, and provide a report within 18 months, to determine whether it is necessary, in order to strengthen the safety and soundness of institutions or the stability of the financial system, to eliminate the BHCA exemptions for holding companies of savings associations, credit card banks, trust companies and industrial banks.

Provisions Regarding Control of a Savings Association

- *Exemption for Trust-Only Savings Associations.* A company is not a savings and loan holding company by virtue of controlling a saving association that functions solely in a trust or fiduciary capacity.
- *Clarification of Savings and Loan Holding Company Powers.* Savings and loan holding companies are permitted to engage in all activities permissible for financial holding companies, subject to all the qualifications and standards that apply to the conduct of such activities by financial holding companies.
- *Commercial Firms that Control Savings Associations.* If a grandfathered unitary savings and loan holding company engages in any activities other than those permissible for non-grandfathered savings and loan holding companies (generally, these are financial activities permissible for a financial holding company under BHCA Section 4(k)), then the Federal Reserve Board may require such company to establish and conduct all or a portion of its financial activities in or through an intermediate savings and loan holding company, established pursuant to regulations of the Board. However, the Federal Reserve Board must require a grandfathered unitary savings and loan holding company to establish an intermediate holding company, if the Federal Reserve Board determines that the intermediate holding company is necessary to appropriately supervise the company's financial activities or to ensure that supervision by the Federal Reserve Board does not extend to the activities of such company that are not financial activities. The Federal Reserve Board is required to establish standards for these determinations by regulation. By virtue of a new exemption, a grandfathered unitary savings and loan holding company that is required to establish an intermediate savings and loan holding company ceases to be a savings and loan holding company itself. Internal financial activities conducted by a former grandfathered unitary savings and loan holding company or any affiliate and internal treasury, investment and employee benefit functions are not required to be conducted in an intermediate holding company. Also, a former grandfathered unitary savings and loan holding company may continue to engage in an internal financial activity outside of its intermediate holding company, unless the Federal Reserve Board determines that engaging in such activity presents undue risk to the former

grandfathered unitary savings and loan holding company or to the financial stability of the United States, if the former grandfathered unitary savings and loan holding company engaged in the activity during the year before the date of enactment of the Act and at least $\frac{2}{3}$ of the assets or $\frac{2}{3}$ of the revenues generated from the activity are from or attributable to the former grandfathered unitary savings and loan holding company. A former grandfathered unitary savings and loan holding company that directly or indirectly controls an intermediate savings and loan holding company must serve as a source of strength to its intermediate savings and loan holding company, and the Federal Reserve Board may examine and require reports from the former grandfathered unitary savings and loan holding company to ensure its compliance with these requirements and may enforce noncompliance. The Federal Reserve Board may issue regulations establishing affiliate transaction limits between an intermediate holding company and its parent former grandfathered unitary savings and loan holding company (and the parent's nonbank subsidiaries), but the regulations may not restrict or limit transactions in connection with a bona fide acquisition or lease by an unaffiliated person of assets, goods or services.

Bank Holding Company Regulation

- *FHC Requirements.* Financial holding companies are required to be well-capitalized and well-managed, which supplements the current requirement that the banks in a financial holding company be well-capitalized and well-managed.
- *Approval of FHC Acquisitions.* Financial holding companies must obtain prior approval from the Federal Reserve Board before acquiring a nonbank company with consolidated assets in excess of \$10 billion.
- *Standards for Interstate Acquisitions and Mergers.* A bank holding company must be well-capitalized and well-managed, not merely adequately capitalized and adequately managed, in order to acquire a bank located outside of the bank holding company's home State. Also, banking agency approval of interstate bank mergers is conditioned on the requirement that the resulting bank be well-capitalized and well-managed upon consummation of the transaction, not merely adequately capitalized and adequately managed.
- *Source of Strength.* A source of strength doctrine is applied to all depository institution holding companies, including commercial companies that control a depository institution. If a holding company is not a bank holding company or savings and loan holding company, it may be required to submit a report under oath assessing its ability to serve as a source of strength.

The Volcker Rule

- *Definition of Banking Entity.* The term "banking entity" is defined as an insured depository institution, a company that controls an insured depository institution, a company treated as a bank holding company and any subsidiaries of such institutions or companies (including broker-dealer and fund manager subsidiaries). A limited exception from the term "insured depository institution," which is used in this definition, is provided for an institution that functions solely in a trust or fiduciary capacity.
- *Prohibition of Proprietary Trading.* Federal banking agencies, through a rule-making, are required to jointly prohibit proprietary trading by a banking entity. "Proprietary trading" is defined as engaging as a principal for one's trading account in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative or contract or any other security or financial instrument that the appropriate Federal banking agency, the SEC or CFTC determines by regulation.
- *Prohibition on Sponsoring or Investing in a Hedge Fund or Private Equity Fund.* Federal banking agencies, through a rule-making, are required to jointly prohibit banking entities from sponsoring or investing in a hedge fund or private equity fund (each defined as a company that is exempt from registration under the Investment Company Act by

virtue of Section 3(c)(1) or 3(c)(7) thereof). “Sponsoring” is defined as serving as a general partner, managing member or trustee of a fund; selecting or controlling a majority of the fund’s directors, trustees or management; or sharing the same name or variation of the same name of the fund.

- *Exceptions.* The foregoing prohibitions do not apply to certain activities, including: (1) investments in obligations of the U.S. government and any agency of the U.S. government, obligations, participations or other instruments of or issued by Ginnie Mae, Fannie Mae, Freddie Mac, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution or to obligations of an State or a political subdivision thereof, (2) underwriting and market-making-related activities, (3) risk-mitigating hedging activities designed to reduce the specific risks to a banking entity in connection with and related to its positions, contracts or other holdings, (4) trading conducted on behalf of customers, (5) investments in small business investment companies, (6) insurance company general account investment activities, subject to certain conditions, (7) organizing or offering a private equity or hedge fund if the banking entity provides bona fide trust services or investment advisory services, the fund is offered in connection therewith and only to the banking entity’s customers and the banking entity complies with certain other conditions generally designed to limit the banking entity’s risk exposure to the fund, (8) activities conducted by a foreign company solely outside the U.S. provided the company is not directly or indirectly controlled by a U.S. domestic company and that no interest in a hedge fund or private equity fund in which the company invests or that it sponsors is offered for sale or sold to a resident of the U.S. and (9) such other activity as permitted by regulation of the Federal banking agencies, SEC and CFTC to promote and protect the safety and soundness of the banking entity and the financial stability of the U.S. The exceptions do not apply if, as determined by regulation of the Federal banking agencies, SEC and CFTC, an activity involves or results in a material conflict of interest between the banking entity and its clients, customers or counterparties; results, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies; poses a threat to the safety and soundness of such banking entity; or poses a threat to the financial stability of the U.S. Moreover, the Federal banking agencies, SEC and CFTC must issue regulations imposing additional capital requirements and quantitative limits on such activities.
- *De Minimis Investments.* If a banking entity organizes and offers a hedge fund or private equity fund, the banking entity may make and retain an initial investment. Within one year after establishment of the fund, the investment must be reduced to 3% or less of total ownership interests and be immaterial to the banking entity (the maximum of all such investments must be 3% or less of the banking entity’s Tier 1 capital). The Federal Reserve Board may extend the one-year period for two additional years.
- *Council Study.* The Oversight Council must conduct a study of the provisions of the Volcker Rule and issue recommendations to the Federal banking agencies within six months of the enactment of the Act. Within nine months of the date the study is completed, the Federal banking agencies, the SEC and CFTC must issue coordinated final rules implementing the Volcker Rule.
- *Divestiture Period.* Banking entities must dispose of prohibited investments or relationships within two years after the Volcker Rule requirements become effective (which occurs on the earlier of 12 months after the issuance of final regulations or two years after enactment) or two years after a banking entity becomes a nonbank financial company subject Federal Reserve Board supervision under Title I of the Act, subject to up to three possible one-year extensions. An additional extension of up to five years may be granted by the Federal Reserve Board to the extent necessary in the case of a banking entity that is subject to a contractual obligation that was in effect on May 1, 2010 regarding an investment in, or capital commitment to, an illiquid fund. Thus, in some instances, a banking entity could have up to 12 years to divest a prohibited investment. The Federal banking agencies, SEC and CFTC must issue rules to apply during the divestiture period that impose additional capital requirements and other restrictions on banking entities that sponsor or invest in hedge funds or private equity funds.

- *Affiliate Transaction Restrictions.* Entities covered by these provisions that serve as an investment manager or investment adviser to a hedge fund or private equity fund, or that organize or offer a hedge fund or private equity fund under the exception for trust services and investment advisory services, and their affiliates are prohibited from entering into covered transactions, as defined in Section 23A of the Federal Reserve Act, with such hedge fund or private equity fund (e.g., loans to the fund, purchasing assets from the fund, guaranteeing an obligation of the fund). In addition, each such entity is subject to Section 23B of the Federal Reserve Act as if such entity were a member bank and such hedge fund or private equity fund were an affiliate. A limited exception from the 23A prohibition is provided for prime brokerage, although neither the Act nor the BHCA define “prime brokerage.” Under this exception, a banking entity may engage in a covered transaction with a hedge fund or private equity fund in which a hedge fund or private equity fund managed, sponsored or advised by such banking entity has taken an ownership interest. The following conditions apply to the exception: (1) with regard to a hedge fund or private equity fund organized and offered by such banking entity, the banking entity must comply with each of the conditions in the exemption for banking entities that provide bona fide trust services or investment advisory services in connection with organizing or offering a private equity or hedge fund, (2) the chief executive officer (or equivalent officer) of the banking entity provides an annual certification that the banking entity does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the hedge fund or private equity fund or of any hedge fund or private equity fund in which such hedge fund or private equity fund invests and (3) the Federal Reserve Board has determined that the transaction is consistent with the safe and sound operation and condition of the banking entity.
- *Limitations on Nonbank Financial Companies.* The Federal Reserve Board is required to adopt rules that impose additional capital requirements and quantitative limits on nonbank financial companies it supervises pursuant to Title I of the Act that engage in proprietary trading or sponsoring or investing in hedge funds or private equity funds.

Concentration Limits

- *Concentration Limit on Financial Companies.* A financial company is prohibited from merging or consolidating with or acquiring another company if the total consolidated liabilities of the acquiring financial company upon consummation of the transaction would exceed 10% of the aggregate consolidated liabilities of all financial companies at the end of the calendar year preceding the transaction. Exceptions are provided for acquisitions of failing banks, FDIC-assisted transactions and transactions that result in a *de minimis* increase in the liabilities of a financial company.
- *Financial Company Definition.* “Financial company” is defined as an insured depository institution, bank holding company, savings and loan holding company, company that controls an insured depository institution, nonbank financial company supervised by the Federal Reserve Board under Title I of the Act and a foreign bank or other company treated as a bank holding company.
- *Concentration Limit on Insured Depository Institution Mergers and Acquisitions.* An insured depository institution is prohibited from engaging in an interstate merger transaction if the resulting insured depository institution (including all insured depository institutions which are affiliates of the resulting insured depository institution), upon consummation of the transaction, would control more than 10% of the total amount of deposits of insured depository institutions in the U.S. An exception is provided for acquisitions of failing banks and FDIC-assisted transactions. The prohibition and exception also apply to bank holding company and savings and loan holding company interstate acquisitions of insured depository institutions that together with affiliates control more than 10% of the total deposits in the U.S.

Securities Holding Company Registration

- *Federal Reserve Board Registration.* A securities holding company required by a foreign regulator or foreign law to be subject to comprehensive consolidated supervision may register with the Federal Reserve Board.
- *Securities Holding Company Definition.* “Securities holding company” is defined as a company that owns or controls one or more SEC-registered broker-dealers and does not include a systemically important nonbank financial company supervised by the Federal Reserve Board or other entities already subject to comprehensive supervision by the Federal Reserve Board or a foreign regulator.
- *Federal Reserve Board Supervisory Authority.* The Federal Reserve Board is permitted to examine any registered securities holding company and any affiliate and to impose capital adequacy and other risk management standards on registered securities holding companies.
- *Application of BHCA.* Registered securities holding companies are generally subject to the provisions of the BHCA, except for the restrictions on nonbanking activities and investments in Section 4 of the BHCA and except as the Federal Reserve Board may otherwise provide by regulation or order.

Other Provisions

- *Affiliate Transactions.* Existing restrictions on transactions with affiliates are enhanced, including by adding securities lending transactions and derivative transactions as “covered transactions.”
- *Lending Limits on State Bank Derivatives Activities.* State banks may only engage in derivatives transactions if the law with respect to lending limits of the State in which the State bank is chartered takes into consideration credit exposure to derivative transactions.
- *Insider Lending.* Existing restrictions on lending limits to insiders are enhanced, including by expanding transactions subject to limits to include credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction.
- *De Novo Branching.* National banks are authorized to establish a *de novo* branch in another State.
- *Capital Regulations.* The authority of the Federal banking regulators to establish bank holding company and savings and loan holding company capital standards is clarified, and Federal banking regulators are instructed to make capital requirements for such holding companies and for depository institutions countercyclical.
- *Interest on Demand Deposits.* The prohibition on paying interest on demand deposits is repealed, effectively allowing depository institutions to offer interest checking to business customers.
- *Conflicts of Interest Relating to Securitizations.* For a description of the Act’s provisions relating to securitization conflicts of interest, see “Title IX—Investor Protections and Improvements to the Regulation of Securities—Subtitle D—Improvements to the Asset-Backed Securitization Process—Securitization Conflicts of Interest.”
- *Credit Card Bank Activities.* Credit card banks are authorized to engage in credit card lending to small businesses as defined in Small Business Administration regulations.

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