Transcript of Open Board Meeting
January 30, 2020

CHAIR POWELL. Good morning. I'd like to welcome our guests here at the Federal Reserve Board and our online viewers.

This morning, we will consider two items. The first is a proposal to simplify and clarify the restrictions applying to investment funds covered by the Volcker rule, known as covered funds. The second is a final rule to increase transparency and simplify the way we determine who controls a banking organization.

As I have said before, the intent behind the Volcker rule is the right one—banks should not use deposits that are insured by taxpayers to make risky proprietary trades or investments in hedge funds and private equity funds. We now have considerable supervisory experience putting that common sense prohibition into practice, and we have learned that a simpler, clearer approach to implementing the rule makes it easier for both banks and regulators to carry out the intent of the rule. We have already taken several steps in that direction and the proposal before us continues that work.

For example, the proposal addresses the extraterritorial treatment of certain foreign funds that have been unintentionally affected by the rule. In addition, the proposal would simplify and clarify the application of various provisions of the Volcker rule to covered funds. And, as staff members will detail, the proposal will also permit banks to provide limited services to covered funds in ways that do not raise the types of concerns the Volcker rule was intended to address.

After discussing covered funds, we will then turn to a final rule that would significantly improve transparency around how we determine who controls a banking organization and who a banking organization controls. The rule clearly lays out the key factors and thresholds that the Board will take into account and the combination of factors that would and would not trigger

control. This should reduce complexity and reduce compliance burdens for banks and their investors.

With that, I'd like to turn it over to Vice Chair for Supervision Quarles for his statement.

VICE CHAIR FOR SUPERVISION QUARLES. Thank you.

Thanks. I want to thank our staff for their work on these important projects and as well as the staff of the four other agencies responsible for implementing and enforcing the Volcker rule, and I'd like to thank them all for the quite exceptionally high level of professionalism, collegiality, and dedication in these projects.

The objective behind the Volcker covered funds proposal is straightforward: simplifying the Volcker rule in light of our experience with the rule over six years of implementation. This is a goal that is shared among all five agencies and among policymakers at those agencies with many different backgrounds. Since the agencies originally finalized the Volcker rule regulation in December of 2013, each agency has collected and reflected on many lessons learned. In particular, it is inescapable that compliance and enforcement have been difficult and can be simplified for both banking entities and regulators.

The Volcker covered funds proposal has been informed already by significant public input. Notably, the Volcker proposal on proprietary trading which we made in 2018 invited comment from the public on how the covered funds provisions could be improved. Many comments have been received in response over the subsequent 18 months, and this proposal takes into account many of those comments.

Broadly, the changes in the proposal can be grouped into three buckets: First, improving and clarifying the treatment of foreign funds; Second, simplifying and clarifying the operation and compliance requirements of the rule; And third, permitting banking entities to engage in

additional fund-related activities, which don't present the risks that the Volcker rule was intended to address.

Let me focus quickly on the third bucket of changes. They would allow a banking entity to engage in certain activities indirectly through a fund structure. But existing law has always allowed banks to engage directly in these activities. So to put it plainly: Today's proposal simply allows banks to engage in already permitted activities, such as venture capital investment, through a fund structure. And to mitigate any risks present with activity through a fund, the proposal does not allow banks to engage in proprietary trading through a fund structure, restricts a banking entity from bailing out the funds it sponsors, limits conflicts of interest between the banking entity and fund, and of course, the activity remains subject to the same strict capital charges even if it is conducted through a fund structure.

The proposal seeks comment on a variety of fronts, ranging from narrow to broad, and I encourage views from all sides to weigh in on how the proposal can be improved, while maintaining the safety and soundness of firms and complying with statutory requirements. We will genuinely listen to those comments and take them into account as we formulate a final rule. I very much look forward to public feedback on the Volcker covered funds proposal.

Turning to "control," the concept of control is a threshold issue for the Board because it determines the perimeter of the Board's supervisory and regulatory authority over depository institution holding companies. Under the Bank Holding Company Act and the Home Owners' Loan Act, the Board is charged with oversight over companies that control a bank or savings association.

The Board's control regime has developed over many decades through an opaque common law process and has become one of the more ad hoc and complicated areas of the

Board's regulatory administration. The complexity and relative lack of transparency of the Board's case-by-case approach to control can impose a substantial compliance and uncertainty burden on the public, especially banking organizations and investors. By establishing a broadly applicable and uniform set of rules, the final rule being considered today is intended to enhance the predictability, simplicity, and transparency of the Board's framework for evaluating control.

Many of the control doctrines of the Board and staff have been unwritten or have been written, but not well publicized. Most of the control doctrines of the Board and staff also had never before this gone through the crucible of a public comment process. I am pleased that these doctrines will now be available to the public with a framework that has been determined after going through the standard notice-and-comment process.

Thank you.

MARK VAN DER WEIDE. Thank you, Vice Chair Quarles. We'll start with the Volcker Rule and then move to the controls item. Before I turn the presentation over to Greg Frischmann and Flora Ahn for a walkthrough of the principal elements of the proposal on Volcker, I want to reinforce that our work on the Volcker Rule covered funds provisions was guided by a desire to implement the statute in a simpler, more efficient way but consistent with the statutory text and consistent with the three key prophylactic purposes of the statutory provisions.

First, to prevent banking entities from taking outsized risks in their fund investment activities; second, to prevent banking entities from using investment funds to circumvent the proprietary trading provisions of the rule; and third, to prevent banking entities from providing guarantees or bailouts to sponsored funds. This triumvirate of objectives served as the load star, the cynosure of all our work. Greg over to you.

GREG FRISCHMANN. Thank you, Mark. Today's proposal concerns the covered fund provisions of the Volcker Rule. These provisions of the Volcker Rule limit the ability of banking entities to invest in or sponsor private equity funds and hedge funds. The proposed rule is the result of a coordinated interagency effort. We will provide an overview of the proposal and highlight the key proposed differences from the existing rules. Following staff remarks, we would be happy to answer questions about the proposal.

The agencies have long acknowledged that the core broad statutory definition of private equity funds and hedge funds in the Volcker Rule covers many types of funds that Congress did not intend to address. Congress gave the agencies substantial authority in the Volcker Rule to tailor the broad statutory definition to better track legislative intent. Today's proposal will use the substantial discretion resident in the text of the Volcker Rule statute to improve the rule's treatment of foreign funds; simplify and clarify operation of the rule; and permit banking entities to engage in additional fund activities that do not present the risks that the Volcker Rule was intended to address.

The first issue I would like to discuss is how the proposal would refine the conditions applicable to certain foreign fund activities. Under the current regulations, the Volcker Rule may have unintended extraterritorial impact on certain funds that are organized by foreign banks in a foreign jurisdiction and that are sold only to foreign investors. I will refer to such funds as foreign-excluded funds. These funds are generally excluded from the definition of covered fund under the agency's rules but could become subject to the proprietary trading provisions of the rules because they are controlled by a foreign bank. The banking agencies have provided temporary relief to these funds through public policy statements that indicate the agencies would not recommend taking enforcement action against foreign banks with respect to their foreign-

excluded funds. The proposal would create a narrowly-tailored permanent exemption for foreign-excluded funds. The exemption will be subject to significant limits to prevent evasion of the Volcker Rule, including the conditions previously established by the banking agencies in the no-action statements. A fund that meets the rigorous eligibility requirements of the proposal would not be bound by the restrictions of the Volcker Rule.

Separately, the proposal would simplify the requirements in the existing regulations that allow domestic and foreign banking entities to organize and offer funds sold to foreign retail investors. Consistent with the statute, the current regulations exclude U.S. mutual funds from the covered fund provisions of the Volcker Rule. The current regulations also endeavor to provide parity of treatment between U.S. mutual funds and foreign public funds, which are effectively foreign equivalents of U.S. mutual funds. The current regulations, however, impose stricter eligibility criteria on the exclusion for foreign public funds, which make it difficult for banking entities to use the exclusion.

Under the proposal, a foreign public fund must be offered through at least one public offering and be subject to retail investor protection requirements under foreign law. The proposal would eliminate the existing requirement that a foreign public fund be sold predominantly through public offerings. This change would help equalize the treatment of foreign public funds and U.S. mutual funds and reduce unnecessary monitoring obligations around foreign public funds.

The proposal also would eliminate the requirement that a foreign public fund be authorized to be offered and sold to retail investors in the issuer's home jurisdiction. Staff recommends this change because it -- because it is common for foreign public funds organized in one foreign jurisdiction to be offered for sale to retail investors in another foreign jurisdiction.

And we do not think that the Volcker Rule was intended to restrict such a multi-country structure.

The next set of changes would simplify and clarify aspects of the rule that have made it difficult for banking entities to engage in certain activities permitted under the statute. First, the proposal would include minor revisions intended to allow banking entities to more fully engage in loan securitization activities expressly permitted by the statute.

Specifically, the proposal would amend the loan securitization exclusion to permit the holding of a small amount of non-loan assets -- up to 5 percent of the fund's total assets, such as corporate bonds and short-term highly liquid investments.

Second, the proposal would amend the small business investment company exclusion in the rule to permit a fund to continue to qualify under the exclusion while the fund is winding down its operations.

Third, the proposed rule would revise the definition of an ownership interest in a covered fund to make clear that a banking entity can extend credit to an unrelated covered fund without fear that the extension of credit could be viewed as an equity investment in the fund. This change would improve the rule's harmony with the statutory framework, which limits a banking entity's equity ownership of an unrelated covered fund but does not limit a banking entity's extensions of credit to an unrelated covered fund.

Fourth, the proposal would revise an interagency position taken in the preamble to the 2013 rule which suggested that a banking entity should treat its direct investments and the same assets that a sponsored covered fund invests in as investments by the banking entity in the fund itself. Under this 2013 position, direct investments by a banking entity in the portfolio assets of a

fund would be subject to the 3 percent cap on the banking entity's investments in the fund, even if those investments were not made in the fund and were otherwise permissible for the banking entity under applicable law. Consistent with the statutory text and the text of the current regulation, the proposal would clarify the banking entities are not required to recharacterize their direct investment activities as investments in a covered fund.

I will now turn to my colleague Flora Ahn to discuss other aspects of the proposal.

FLORA AHN. The final set of changes would permit banking entities to engage in additional fund-related activities that do not present the risks that Volcker Rule was intended to address. In 2013 the agencies permitted banking entities to -- to sponsor and invest in 13 different types of funds. The proposal would add four additional permissible fund types. These new permitted fund types will be family wealth management vehicles; customer facilitation funds; credit funds; and venture capital funds. Currently there are certain banking and financial services that banking entities directly provide to customers that they are not able to provide through a fund structure because of the covered fund provisions of the Volcker Rule.

Today's proposal would introduce new exclusions for vehicles used to provide banking and financial services to a single family group and to a single customer. Under the proposal the exclusion for qualifying family wealth management vehicles would apply only to a fund owned by members of a single family and no more than three closely-related persons. Similarly, the proposal would include an exclusion for customer facilitation funds, which would only apply to funds set up to facilitate transactions between a banking entity and a single customer. These new exclusions will be subject to several restrictions, such as limiting ownership in the fund by the sponsoring banking entity and prohibiting a banking entity from acquiring low-quality assets

from the fund to help ensure that such vehicles cannot be used to help banking entities evade the requirements of the Volcker Rule.

The proposal also would revise the current rule to allow banking entities to invest in and sponsor credit funds and venture capital funds, which do not present the risks that the Volcker Rule was intended to address. Both loan securitizations and credit funds help facilitate the extension of credit of consumers and businesses and do not resemble the private equity funds and hedge funds Congress intended the agencies to treat as covered funds. The Volcker Rule by statute excludes vehicles established to facilitate the sale and securitization of loans from the definition of covered funds.

In some instances, however, the Volcker Rule has made it difficult for banking entities to invest in or sponsor substantially similar funds that make loans, invest in debt securities, or otherwise extend credit. Therefore, the proposal would allow banking entities to sponsor and invest in credit funds subject to specific eligibility criteria.

Venture capital funds also may be subject to the current Volcker Rule covered fund restrictions. Venture capital funds are an important source of financing for small business and startup firms. Banking entities have authority to make direct equity investments in small businesses, but the Volcker Rule imposes strict limits on their ability to invest in diversified pools of venture equity. The legislative history of the Dodd-Frank Act suggests that a number of members of Congress supported the agencies permitting venture fund investments under the Volcker Rule. This -- the inclusion in the statute of an exclusion for small business investment companies further reinforces the desire of Congress to prevent the Volcker Rule from impeding bank involvement with venture capital funds. Accordingly, the proposal would allow banking entities to sponsor and invest in venture capital funds subject to specific eligibility criteria.

The proposal includes certain restrictions to help ensure that these provisions are not used to evade the textural requirements or the spirit of the Volcker Rule. Under the proposal, both credit funds and venture capital funds would be expressly prohibited from engaging in proprietary trading. In addition, a banking entity that invests in or sponsors such funds would be prohibited from guaranteeing the fund's performance and would be required to disclose this prohibition to the fund's investors. Although a banking entity would be permitted to hold ownership interest in these funds, a banking entity would otherwise be limited in the relationships it could have with such funds.

Finally, the proposal would permit a banking intent to engage in limited low-risk transactions with related covered funds. The current regulations prohibit a banking entity that serves as an investment advisor or sponsor to a covered fund from entering into certain transactions with the fund. Specifically, the rule prohibits transactions between a banking entity and a sponsored or advised fund that would be subject to Section 23a of the Federal Reserve Act.

The proposal would permit a banking entity to enter into certain transactions with a related covered fund. The permitted transactions would include those that at an ensured depository institution may enter into with an affiliate without limit under Section 23a including, for example, interday extensions of the credit. In addition, the proposal would allow a banking entity to extend short-term credit to a related covered fund in connection with providing payment, clearing, and settlement services to the fund.

This concludes staff's prepared remarks. My colleague and I would be pleased to answer your questions.

CHAIR POWELL. Thank you very much for your presentations. I have a couple of questions. So the rule has been in effect for something like six years, I guess, and markets have adapted, regulated institutions have adapted; so why is today's proposal necessary?

FLORA AHN. So I can answer your question. Since the adoption of the covered fund provisions in 2013, the agencies have received a number of comments regarding the extraterritorial impact of these provisions; the restrictions that limit traditional bank services to covered funds; and other concerns regarding the scope of the prohibition.

In addition, staff's experience both in implementing the 2013 rule and in supervising firms for Volcker compliance has suggested the need for certain simplifications, clarifications, and refinements of the rule. Commenters on the 2018 proposal also specifically expressed concern about how the current rule interrupts traditional banking and asset management activities, which don't raise the risks intended to be addressed by the Volcker Rule.

Today's proposal would address some of the concerns with the covered fund provisions, including the extraterritorial application of the rule. It would also give banks slightly more flexibility to offer traditional banking and asset management services such as payment clearing and settlement services provided to affiliated funds. Finally, it would permit banking entities more flexibility -- finally, it would permit banking entities to offer and invest in certain funds that don't pose the same types of risks that the Volcker Rule was intended to address.

CHAIR POWELL. Thank you. I have another question, which is it does -- I would agree that the proposed relief to foreign funds is -- is warranted. But I would -- the question I would ask you is: How comfortable are you that you've calibrated that relief at a level that will leave the foreign banks on a level playing field but not -- not having an advantage over -- over U.S. firms?

FLORA AHN. I'd be happy to answer that question as well. So we're comfortable with the provided relief for several reasons. The proposal provides relief to a limited class of foreign funds organized by foreign banks and offered outside of the United States to foreign investors. In addition, the relief provided is identical in scope to the policy statements that's been previously issued by the federal banking agencies that address this issue.

This exclusion in general would mitigate some of the extraterritorial impact of the Volcker Rule while limiting opportunities for banking entities to evade the requirements of the rule. It's also clear that the statute differentiates between U.S. firms and foreign firms in certain key respects. For example, the statute provides foreign firms with greater latitude to engage in -- in covered fund investment and sponsorship activities, as well as proprietary trading activities outside of the United States. So we're comfortable -- we think our proposal here is consistent with Congressional intent.

Finally, I would note that foreign banks would continue to be subject to the same limitations as U.S. funds with respect to asset management activities conducted in the United States.

MARK VAN DER WEIDE. I would just add one additional point. As a general matter, when we craft our regulations, we try to minimize the extraterritoriality of those regulations on foreign firms if we have statutory authority to do that -- we do here -- and that's part of a more complicated kind of multistep process where we also have the same expectation for foreign countries. We expect them to minimize the extraterritoriality of their rules on our firms. So for us, again, from a reciprocity consideration providing this sort of a -- extraterritoriality relief to foreign funds is, I think, part of a longer-term kind of agreement among nations to try and minimize the -- the burden on foreign firms of their domestic rules.

CHAIR POWELL. Great, thank you very much. I'm now going to ask my colleagues if they have any questions they'd like to ask on this topic, beginning with Vice-Chair Clarida.

VICE CHAIR CLARIDA. Thank you, Chair Powell. I -- I have no questions as usual. I received a thorough and comprehensive briefing from staff and that answered my questions.

CHAIR PWELL. Thank you. Vice-Chair Quarles?

VICE CHAIR FOR SUPERVISION QUARLES. Well, I think I know the answer to this, but let me ask it. But -- but -- but I think is an important question, so let me ask it anyway. So -- but one of the -- one of the major purposes of the covered funds provisions is to -- the major purpose is to prevent banks from creating structures to do indirectly what -- what the Volcker Rule would not prevent them to do directly. So the -- the proposal that we're making today would -- you know, don't themselves have any particular cap on how much a bank could own of a covered fund. So -- so what makes us comfortable that this couldn't be an evasion mechanism? A bank could own sort of a very large percentage of one of these covered funds and therefore effectively be the entity that was conducting one of these [inaudible] directly.

FLORA AHN. So I'd be pleased to answer that -- answer that question as well. So the proposal includes several eligibility criteria and restrictions that limit the scope of the proposed fund activities and are intended to address the evasion risks. All the proposed preventive fund provisions would also prohibit a banking entity from guaranteeing the performance of the fund. So this prohibition would address the statutory concern that banking entities could have incentives to bail out funds that they organized and offer. In addition, the existing capital regulations impose high-capital requirements on any investments and risky funds.

VICE CHAIR FOR SUPERVISION QUARLES. Thank you.

CHAIR POWELL. Thank you. Any questions, Governor Brainard?

GOVERNOR BRAINARD. No, I also appreciated all the information from staff. Thank you.

CHAIR POWELL. Governor Bowman?

GOVERNOR BOWMAN. Yes. Thank you, Mr. Chair. So the question I have relates to smaller -- smaller regional and community banks. So how -- actually, focusing more on the regional banks. So how does the Volcker proposal treat the non-complex and smaller banks that are not excluded from the rule, as community banks are now excluded from the rule? For example, those that fall within the $10 billion to $50 billion range or even up to $100 billion?

GREG FRISCHMANN. Thank you for your question, Governor Bowman. The changes in the proposal do generally apply to all financial institutions subject to the rule; however, there are many non-complex and smaller institutions that engage in fund activities that could be directly impacted by the proposal. And I'd like to give sort of three examples, I think, that are -- are salient. One, the proposal may give smaller institutions flexibility to provide services to their customers, for example, families in the communities they serve. Currently smaller banks may give, you know, asset management services or other sort of estate planning services to families. And they can do this directly or they can do it through a trust structure. The proposal would permit banking entities -- smaller, non-complex banking entities -- to provide these services through an investment vehicle set up just for that family. That's -- I think that's a helpful tool that would be available to smaller and non-complex institutions. There's also perhaps greater flexibility for smaller banking institutions in making investments. So I'd point out two particular provisions that may be useful. One change, while it seems minor on its face, could be helpful,

and that's the -- the clarification with respect to small business investment companies. Currently small business investment companies -- investments are permitted by the statute but only so long as they have a license. Typically and -- and quite often a small business investment company during the wind-out phase will relinquish that license and therefore call into question whether the investment in the SBIC is permissible. This rule would clarify that no, it remains throughout that life cycle of the SBIC -- the small business investment company. Another example -- I think Flora addresses this a little bit -- was permitting venture capital fund investments. The proposal would give smaller banks and non-complex banks sort of greater flexibility to support businesses in their local communities. And, again, these banks may not have the balance sheets that would justify making the same number and degree of -- of sort of diversified investments. But now through a fund structure maybe that facilitates a more diversified investment in the same venture capital fund investments.

GOVERNOR BOWMAN. Thank you, I appreciate you guys answering my question and for the very in-depth briefings that you provided prior to the meeting today.

CHAIR POWELL. Thank you. Thank you. And now back to Mark Van Der Weide to introduce the second discussion item.

MARK VAN DER WEIDE. Thank you, Chair Powell. This final control rule that we're going to discuss in the second part of the program has been decades in the making. Banking firms and investors in banking firms have spent a lot of time over the past few decades importuning Board staff for control opinion about a proposed investment in a banking firm or by a banking firm. While staff often has been able to give a clear and quick answer, the prosecution of other control questions has resembled more the attempts of Kafka's protagonist K to get answers from the government authorities in the castle. I think this final rule will be a great leap

forward in transforming a set of gnostic rules of thumb that had been developed through a mostly hermetic common law process by a set of Board staff priests and acolytes, myself among them, into a set of comprehensive, uniform, consistent public rules available to all. I will now turn it over to Greg Frischmann and Mark Burish to provide an overview of the final rule.

GREG FRISCHMANN. Thank you, Mark. The final rule establishes a new control framework that would provide greater clarity and transparency by updating the Board's regulations related to control under the Bank Holding Company Act and the Homeowner's Loan Act. Control is a foundational concept under both the Bank Holding Company Act and the Homeowner's Loan Act. Control determines whether or not entities are regulated by the Board as bank holding companies and savings and loan holding companies or as subsidiaries of bank holding companies and savings and loan holding companies. Under the statutory framework, control exists if certain bright-line standards are satisfied or if the Board determines there to be controlling influence based on all the facts and circumstances presented. Over many years, the Board has had considerable experience applying this standard on a case-by-case basis. The final rule would significantly improve transparency around the Board's views on what generally constitutes a controlling influence by providing a clear set of standards to the public. The final rule is generally similar to the proposal, with a few adjustments that we will describe. Under the Bank Holding Company Act a bank holding company is defined as a company that controls a bank. Under the Homeowner's Loan Act, a savings and loan holding company is defined as a company that controls a savings association. The Bank Holding Company Act provides three tests for control: First, a company controls another company if it controls 25 percent or more of any class of voting securities of the other company; second, a company controls another company if it controls the election of a majority of the directors of the other company; the third test for

control is more complex because it involves a fact-based determination by the Board. Under this third test, a company controls another company if the Board determines that it exercises a controlling influence over the management or policies of the other company. The definition of control in the Homeowner's Loan Act is substantially similar. Over time, review of controlling influence fact patterns on a case-by-case basis has led the Board and staff to develop internal general standards for common controlling influence questions. The case-by-case reviews frequently involve assessment of confidential business information, and the staff's conclusions often are not issued publicly. Establishing a comprehensive public framework to describe the common features of investments that generally raise control concerns should make it less difficult for the public to evaluate questions of control. Banking organizations have stated that the lack of transparency around the Board's control framework causes difficult for banks seeking to raise and deploy capital. The downsides of this lack of transparency have been felt most acutely by community banks, which are more likely to rely on a capital base with a few significant investors. I will now turn to my colleague, Mark Burish, who will describe the final rule in more detail.

MARK BURISH. Thank you, Greg. The final rule is generally consistent with the proposal, though several changes have been made after consideration of public comment. The proposal's signature element was a new, clear, and transparent tiered framework for control that was designed to reflect the major factors and thresholds that the Board has viewed as indicators of control. The proposal also provided clarifications to important control-related concepts and definitions. The proposed tiered framework focused on two critical dimensions of control: First, the amount of voting securities controlled by the investor; and second, other specific relationships between the investor and the target company. The proposal provided a matrix in

which different combinations of voting securities and other relationships would trigger presumptions of control. As a general matter, an investor with a larger percentage of voting securities in another company would have been required to have smaller relationships in other areas to avoid control over the other company. Beyond voting securities, the proposal focused on the following other relationships: Non-voting equity investments; rights to director representation; management, employee, or director interlocks; agreements that allow a company to influence or restrict management decisions; and business relationships. The Board has often considered these types of relationships when evaluating control concerns. In addition to setting forth the core tiered framework, the proposal provided certain new definitions, standards, and other presumptions. For example, the proposal clarified that a company with less than 10 percent of the voting securities of another company generally would be presumed to not control the second company. The proposal also clarified that the -- the Board's heightened expectations in situations where a company seeks to terminate an existing control relationship. Other elements included clarifications on how to calculate one company's total equity investment in another; how to distinguish voting securities from non-voting securities; and what types of contractual rights may raise control concerns. The final rule is largely consistent with the proposal, though staff is recommending certain changes in response to public comment. As with the proposal, the core of the final rule is a series of tiered presumptions of control based on a company's level of voting securities in another company and other relationships with the other company. The memorandum to the Board for today's meeting includes a table showing how the control standards would apply across different ranges of voting equity. The final rule's tiered framework differs from the proposal in two ways that I want to highlight. First, the final business relationship standards only take into account the perspective of the target company, not the perspective of the investor. This

change simplifies the framework and recognizes that business relationships that are significant from the perspective of the target company provide the investor with a more direct and powerful lever to exercise control than business relationships that are only significant from the perspective of the investor. Second, the final rule simplifies the total equity standards for bank holding companies. Under the proposal, a non-controlling investor could have up to one-third of the total equity of the target company if the investor's voting interest was less than 15 percent. A non-controlling investor with a voting interest of 15 percent or more was limited to a total equity interest of less than 25 percent. The final rule removes the 15 percent voting standard and applies a total equity cap of one-third to all non-controlling investors. Staff believes that this change is appropriate to simplify the framework and to reflect the lesser relative control power of non-voting equity compared to voting equity. Outside of the core tiered framework, I'd like to flag four items. First, the final rule includes a heightened standard for terminating an existing control relationship without change from the proposal, though certain public comments recommended removing the standard. But legislative history and relative case law strongly support retention of a heightened standard for terminating an existing control relationship. Under the final rule, as under the proposal, a controlling company may break control either by divesting to a voting interest of less than 15 percent or divesting to a voting interest of less than 25 percent and waiting two years. Second, the final rule includes a standard for control where one company consolidates another company on its financial statements under US generally accepted accounting principles. Certain commenters urged the Board to eliminate this part of the proposal, but staff recommends retaining it without change. Staff believes incorporating accounting standards will increase transparency, reduce compliance burden, and increase harmony between the accounting and bank regulatory frameworks. Third, the final rule includes a slightly revised standard for control over investment

funds. Specifically the final rule does not include the proposal's special standard for SEC-registered investment companies. Staff believes that the general investment fund standard and the final rule provides an appropriate treatment for SEC-registered funds and that removal of the special standard for SEC-registered fund will clarify and simplify the framework without materially altering the stringency of the rule. Fourth, the final rule includes a standard for non-control without change from the proposal. Under the standard, a company that owns less than 10 percent of the voting securities of another company generally would not have control. Finally, I note that the final rule adopts various control-related definitions and calculation methodologies as well with a few adjustments relative to the proposal in response to public comment. The most significant of these changes involve modest tweaks to the total equity calculation methodology. Staff believes that these changes are appropriate to simplify and clarify the framework without resulting in materially different outcomes relative to the proposal. Thank you. And we'd be happy to address any questions you may have about the final rule.

CHAIR POWELL Thanks again for your presentations. And we have an opportunity for questions beginning with Vice-Chair Clarida.

VICE CHAIR CLARIDA. I have no questions, Chair Powell.

CHAIR POWELL. Vice-Chair for Supervision Quarles?

VICE-CHAIR FOR SUPERVISION QUARLES. So one question and I think an important question to discuss. So historically, given that there wasn't a regulation or a really public framework around this, the -- the -- the Board's control precedence were essentially enforced by investors signing onto a series of commitments made over time. Those have become routinized, but, you know, occasionally there were kinks or fill-ups in them. Will those passivity

-- now in this new framework and with the public regulation, will we continue to seek those passivity commitments from investors?

MARK BURISH. I -- I can answer that. Staff believes that passivity commitments will generally no longer be necessary to address controlling influence concerns, at least in the ordinary course. Instead, investors in most cases will be able to rely on the tiered framework in the final rule to determine whether or not they may be considered to have control over another company.

CHAIR POWELL. Thank you. Thank you. Governor Brainard? Governor Bowman?

GOVERNOR BOWMAN. Yes, Mr. Chair, I have question about how this rule applies to our smaller and community banks. And in specific -- specifically, how does it assist them with business planning, and decision-making, and potential acquisition planning, those kinds of things for the community and smaller banks?

MELISSA CLARK. I'll take that [inaudible] is it -- these new -- the transparency of the final rule should facilitate in the development of instruments in -- in overall capital raises for smaller organizations, which are often closely-held and they have -- they can't go to the public markets to raise capital. They are privately-negotiated transactions for the most part, and these rules should facilitate that process.

GOVERNOR BOWAN. Thank you.

CHAIR POWELL. Thank you. And thanks again. I'm now going to turn to my colleagues for their positions on -- on these two matters, beginning with Vice-Chair Clarida.

VICE-CHAIR CLARIDA. Thank you, Chair Powell. I support the final control rule before the Board today. The final rule will provide significant clarity to the public by distilling the Board's standards into a transparent and comprehensive framework laid out clearly in regulation. I think this is a big step forward. This important increase in transparency will help all parties better understand the Board's views on these concepts. And Chair Powell, I also support a notice of proposed rule-making on Section 13 of the Bank Holding Company Act, the Volcker Rule. I support issuing this notice and very much look forward to, as I always do, and will study carefully the comments received on this important matter. Thank you.

CHAIR POWELL. Thank you. Vice-Chair for Supervision Quarles.

VICE-CHAIR FOR SUPERVISION QUARLES. Thank you, Chair. I support both measures before us -- the proposal on covered funds under the Volcker Rule and the final rule on control. Like Vice-Chair Clarida, I'll be looking forward to the comments that we receive on the Volcker Rule proposal. But I -- I do think the proposal is a -- it is a very good framework for ensuring that we comply with the law. But -- and -- but allow activities that are in compliance with the law subject to appropriate safeguards. So I'll support both.

CHAIR POWELL. Thank you. Governor Brainard?

GOVERNOR BRAINARD. Thank you. The purpose of the Volcker Rule is to limit banks' exposure to speculative trading activity and risky funds so they don't, again, put taxpayer funds at risk. I have previously supported exempting community banks from the Volcker Rule, and I do support today's proposal to address the inadvertent treatment of foreign funds as banking entities. However, I do have concerns that several of the proposed changes will weaken core protections in the Volcker Rule and enable banking firms to engage in high-risk activities

related to covered funds once again. The proposal opens the door for firms to invest without limit in venture capital funds and credit funds. The proposal suggests these funds don't raise concerns about banks' involvement in risky activity that the Volcker Rule was intended to address. To the contrary, it is clear why Congress legislated the Volcker Rule to limit these types of activities. Some credit funds played a material role in the financial crisis. These funds weren't transparent in their activities, misled invests, and contributed to the financial abuses Congress intended to address. Venture capital funds are a type of private equity fund. As such, they pose similar risks. The agencies determined in 2013 that excluding venture capital funds from the definition of covered funds is not supported by the statutory language. I do not see the basis for excluding venture capital funds. The proposal also asks whether to carve out from the Volcker Rule's restriction on private equity funds those private equity funds that pursue a long-term investment strategy. Such an exclusion appears to be inconsistent with the statute. No change in the statute or in the nature of the activities would call for weakening the protections Congress put in place. With regard to Congressional intent, it is notable that Congress did amend the Volcker Rule two years ago and chose not to make any of today's proposed changes. In particular, Congress chose not to add an exclusion for venture capital funds or credit funds. Finally, pursuant to the 2013 rule, the regulators were clear that a banking entity couldn't evade the Volcker Rule's fund investment limits by creating a synthetic interest in a sponsored covered fund -- this was intended to address the risks that a bank making side investments alongside a sponsored fund and telling fund investors about this side investment would have strong incentives to bail out the fund if it got into trouble. Not only would today's proposal give banking firms the green light to exclude parallel investments from the statutory limits, but it would also explicitly allow them to market the covered fund on the basis of the parallel investments. For these reasons, I do not

support the Volcker covered funds proposal. With regard to control, the final rule substantially increases the transparency and clarity of the Board's control framework, and I do support it. Establishing a comprehensive transparent framework for control should facilitate the consistent application of control standards under the Bank Holding Company Act and the Homeowner's Loan Act and better enable the public to evaluate issues of control when they arise. I appreciate all the work that went into these proposals, and I look forward to public comments. Thank you, Mr. Chair.

CHAIR POWELL. Thank you. Governor Bowman?

GOVERNOR BOWMAN. Thank you, Mr. Chair. First I'd like to discuss the Volcker Rule proposal. Both the Volcker Rule's statute and regulations have changed in several ways over the last few years. Community banks are now exempt from the rule. In 2019 the agencies amended the rule to tailor compliance requirements based on the size -- on size and trading activity. These changes have helped focus the rule on the activities of the largest banks that do the most trading. But even with these changes, the rule's had an impact -- some impact on the smaller non-complex banks including banks that are not engaged in trading activity. I'm hopeful that today's proposal will address some of these impacts on smaller banks and that smaller banks will have -- will provide feedback on the proposal during the comment period. I believe that the changes we're proposing today will stay true to the intent of the statute while reducing burden and making it easier for banks to serve their clients. I support this proposal, and I look forward to reviewing the comments during the comment process. Turning to the final control rule, I believe this rule creates and provides greater transparency, clarity, and certainty to a critical aspect of our supervisory and regulatory work. The rule affects the broad range of entities including community banks. Many banks, especially community banks, have spent a great deal of time,

money, and effort trying to determine whether a particular ownership structure or capital investment could raise concerns under the Board's control standards. By providing a clear roadmap, this rule should make it less complicated for all institutions, particularly for smaller banks to raise capital and make strategic investments with an advanced understanding of the legal implications of those activities. For these reasons, I support this rule. Thank you.

CHAIR POWELL. Thank you. Thanks, everyone, for your comments and views. I will support both the Volcker Rule proposal and the control final rule. As I indicated in my opening remarks, I support the intent behind the Volcker Rule, and it is the law. But a simpler and clearer approach is needed for both banks and regulators. This proposal does that and makes also additional changes that I'm supportive of. I'll be looking forward to the comments we receive and evaluating it. Second, I'm also supportive of the control final rule that will bring much-needed transparency and clarity to that process and will be helpful for everyone. So we will now proceed to -- to an actual vote. And we'll begin with the notice of proposed rule-making on Section 13 of the Bank Holding Company Act. I need a -- a motion to approve a notice of proposed rule-making for revisions to the regulate and [inaudible] implementing Section 13 of the Bank Holding Company Act, commonly known as the Volcker Rule. We'll -- we'll do serial motions and then one vote. So I need a motion to -- I need a motion there.

VICE CHAIR CLARIDA. So moved.

CHAIR POWELL. I need a second.

VICE CHAIR FOR SUPERVISION QUARLES. Second.

CHAIR POWELL. I also need a motion to authorize staff to make conforming non-substantive changes, such as those requested by the OCC, FDIC, SEC, and CFDC in connection with each agency's approval of a substantially similar notice of proposed rule-making.

VICE CHAIR CLARIDA. So moved.

VICE CHAIR FOR SUPERVISION QUARLES. Second.

CHAIR POWELL. And I need a motion to authorize the staff to make minor and technical changes to prepare the related Federal Register documents for publication.

VICE CHAIR CLARIDA. So moved.

VICE CHAIR FOR SUPERVISION QUARLES. Second.

CHAIR POWELL. And I will now ask each of you individually for your votes.

VICE CHAIR CLARIDA. I vote yes on both proposals.

VICE CHAIR FOR SUPERVISION QUARLES. I vote yes.

GOVERNOR BRAINARD. No.

GOVERNOR BOWAN. Yes.

CHAIR POWELL. Okay. Second, we'll vote on the final rule to revise the Board's control framework -- a final rule to revise the regulations related to determining whether one company controls another company and staff to make any minor or non-substantive changes. So I need a motion to approve.

VICE CHAIR CLARIDA. So moved.

VICE CHAIR FOR SUPERVISION QUARLES. Second.

CHAIR POWELL. Here we go. And I'll now ask each Board member individually for your vote.

VICE CHAIR CLARIDA. I vote yes.

VICE CHAIR FOR SUPERVISION QUARLES. Yes.

GOVERNOR BRAINARD. Yes.

GOVERNOR BOWMAN. Yes.

CHAIR POWELL. And yes. So both motions have carried. Thank you very much, everyone. That concludes our meeting. And thanks again to staff for all your great work. Very much appreciated. Thanks again.