

Alert | Financial Regulatory & Compliance



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Amendments to ‘Volcker Rule’ to Exclude Certain ‘Small’ Banks From Key Prohibitions

In connection with the U.S. financial crisis 10 years ago, legislation was adopted to enhance the safety and soundness of the commercial banking system in the United States. Amendments to the Bank Holding Company Act of 1956 required five federal financial agencies¹ to adopt joint regulations to (i) limit the authority of commercial banking institutions to place capital at risk in certain areas involving investment banking, and (ii) forbid banks to permit the name of the bank or certain affiliates of the bank to be used in connection with the operations of private funds. That provision, placed in Section 13 of the 1956 Act, is generally referred to as the “Volcker Rule.”

In 2018 legislation amended the requirements to permit the adopting agencies to revise their rules to exclude from the prohibitions of the Volcker Rule smaller banks previously covered by the rule that have total assets of less than \$10 billion and liabilities that aggregate less than five percent of the total assets of the entity.

Background

Beginning in 1933, commercial banks in the U.S. were barred by the Glass-Steagall Act (GSA) from engaging in investment banking activities so that commercial banking assets in the U.S. would not be put

¹ The five agencies are the Department of the Treasury, the Federal Reserve System, the Federal Deposit Insurance Corporation, the Commodities Futures Trading Commission, and the Securities and Exchange Commission.

at risk by investment banking activities considered to pose a greater risk than traditional banking activities. In 1999 the GSA was repealed by the Gramm-Leach-Bliley Act (generally on party lines in a Republican-controlled Congress), and commercial banks commenced investment banking activities. Many commentators suggest that the repeal of the GSA contributed to the financial crisis in the late 2000s, and that view led to the adoption of new prohibitions imposed on certain activities by the Volcker Rule.

Changes Made Under the Latest Amendments

The Economic Growth, Regulatory Relief, and Consumer Protection Act (2018 Legislation) amended the relevant section of the law to exclude certain community banks and their affiliates from the definition of “banking entity” covered by the Volcker Rule prohibitions.

Many stated purposes were outlined at the time the statute was amended. For example, it was argued that such changes would make more capital available in communities served by such smaller banks, that the limited capital that such smaller banks would be able to utilize for these activities did not pose a systemic risk to the U.S. financial system, and that the kinds of activities in smaller communities that would now be permitted under the legislation tend to be underserved by financial institutions focused on larger markets. When the 2018 Legislation was adopted, it was approved despite concerns that such smaller banks are least suited to bear the risks that will be permitted under the amended Volcker Rule.

The impact of the changes embodied in the new regulations implementing the 2018 Legislation will permit “community banks” to do two things. First, it will allow such banks to utilize up to five percent of their assets for investment banking activities. Second, it will allow an affiliate of such a bank that is not covered by federal deposit insurance to share a name or other identifying label with a private investment fund sponsored by that entity. The changes become effective immediately upon publication in the Federal Register.

Any financial institution considering its status under the revised rule, or how to implement activities now permitted by the rule, should consult with their Greenberg Traurig attorney before proceeding.

Commentary

Whether the ultimate benefits of these relaxed provisions will ultimately outweigh negative risks that may later harm the safety and soundness of the commercial banking system will be tested the next time there is a financial crisis.

Author

This GT Alert was prepared by **Steven M. Felsenstein**. Questions about this information can be directed to:

- **Steven M. Felsenstein** | +1 215.988.7837 | felsensteins@gtlaw.com
- Or your **Greenberg Traurig attorney**

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