Volcker Rule 2.0 is here to stay: Congress refuses to exercise rights under CRA

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It is now widely understood that the set of amendments to the Volcker Rule covered fund provisions that became effective in October 2020 (together with the amendments to proprietary trading provisions that took effect in January 2020, 'Volcker Rule 2.0')[1] are no longer subject to being overturned by the US Congress (the Congress) pursuant to the Congressional Review Act (the CRA).[2] The timing of the approval and the effectiveness of Volcker Rule 2.0 gave rise to apprehension that the new Congress acting in a principled or partisan way could exercise its authority under the CRA to undo the amendments; however, such concerns are no longer relevant.

What Is CRA Review?

Under the CRA, the Congress may reverse certain agency actions retroactively and prohibit an agency from reissuing a new rule that is substantially the same by a joint resolution of disapproval, subject to presidential veto, within 60 session days after the later date of the Congress's receipt, or publication in the Federal Register, of an agency rule.[3] The CRA provides the Congress with a powerful tool to conduct oversight of agency actions, in particular, during a 'lookback' period following the inauguration of a new president, because when the Congress adjourns within 60 session days, a review period under the CRA will reset in its entirety in the next session of the Congress, giving the new Congress a full period to disapprove a rule.

Now, we are well into the 117th Congress, and the reset review period for the covered fund portion of Volcker Rule 2.0 under the CRA appears to have passed, which leaves these amendments intact.

How did CRA affect Volcker Rule 2.0 implementation?

By way of background, Volcker Rule 2.0 was designed to address some concerns raised by industry professionals in the original Volcker Rule and provide clarity and remove undue compliance burdens on banking entities and participants in markets such as imposing unnecessary costs or reducing access to capital and liquidity. With respect to the 'covered fund' portion of Volcker Rule 2.0, proposed in February 2020 and adopted in July 2020, it became effective in October 2020 shortly before the elections that led to a new presidential administration and a knife-edge Democratic majority in the Congress.[4]

1 84 Fed. Reg. 61974 (Nov. 14, 2019).

2 5 U.S.C. §801.

3 See U.S. Congressional Research Service, The Congressional Review Act (CRA): Frequently Asked Questions (Jan. 2020), p. 13.

4 See 85 Fed. Reg. 46422 (July 31, 2020).

Volcker Rule 2.0 expanded the exclusion from the scope of the definition of "covered fund" to include certain specific types of funds such as credit funds, venture capital funds, family wealth management vehicles, and customer facilitation vehicles. It also provided additional flexibility in existing covered fund exclusions, such as by expanding permissible loan securitisations to include non-loan assets and by easing the requirements for foreign public funds.

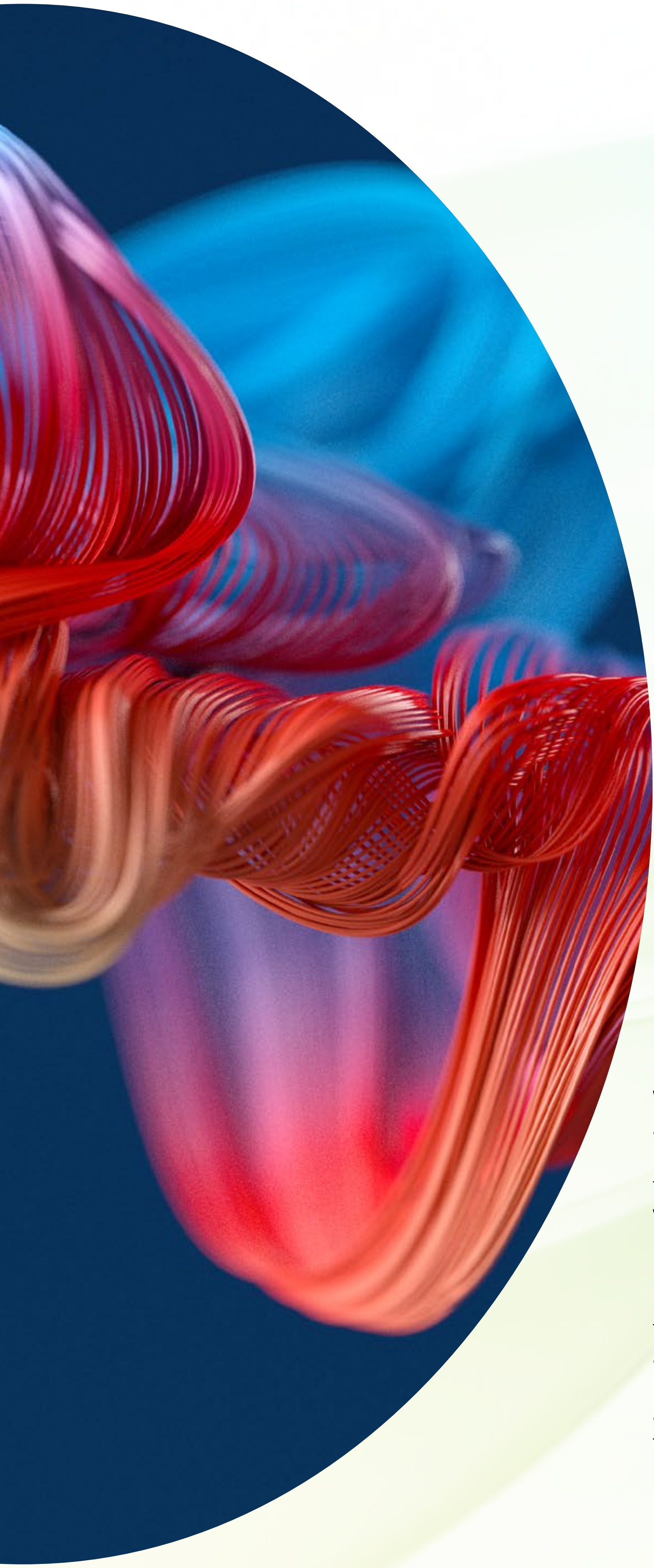
Volcker Rule 2.0 has been largely welcomed by the investment management industry because it provides additional investment opportunities to enhance customer-oriented asset management services. However, as described above, because of the timing of the approval and the effectiveness of Volcker Rule 2.0, concern was raised that the new Congress could exercise its CRA authority to undo these changes. This concern balanced the enthusiasm for the relaxation of the covered fund regime introduced by Volcker Rule 2.0 changes. As a consequence, some investment management firms appear to have decided to wait for the CRA review period to end before structuring their funds to take advantage of the benefits of Volcker Rule 2.0.

Second Look at Volcker Rule 2.0

With the Damocles' sword of CRA review no longer hanging over Volcker Rule 2.0, it is worth taking a second look at key features of the amendments. Principal among these are the following:

- New exclusions from the covered fund definition
    - Credit fund: A qualifying credit fund is a fund that invests in loans, debt instruments, other related or incidental assets (including equity securities, options, and warrants received on customary terms in connection with the fund's investing in loans or debt instruments), and interest rate or foreign exchange derivatives related to loans, debt instruments, or other assets. The fund is subject to a prohibition on proprietary trading, issuing asset-backed securities, or engaging in certain transactions with a sponsoring or investment adviser banking entity (known as 'Super 23A'), and the banking entity may not guarantee the fund's performance.
    - Venture capital fund: A qualifying venture capital fund is an issuer that represents to investors that it pursues a venture capital strategy and meets other requirements to qualify the "venture capital fund" definition in the Securities and Exchange Commission rule.[5] The fund is subject to prohibitions similar to credit funds.
    - Family wealth management vehicle: A qualifying family wealth management vehicle is a trust in which all the grantors are family customers, or a non-trust entity, a majority of the interests of which are held by family customers and up to five closely related persons (although up to 0.5% of the outstanding ownership interest may be held by a banking entity). Family wealth management vehicles are intended to allow banking entities to provide traditional banking and asset management services for family customers.
    - Customer facilitation vehicle (fund of one): This exclusion allows a banking entity to provide services to a customer through a special purpose vehicle similar to the way it may provide services directly.
- Additional flexibilities to existing exclusions
    - Loan securitisation: Volcker Rule 2.0 expanded the scope of permissible loan securitisations to permit asset-backed issuers to hold up to 5% of their assets in assets other than loans, however, such assets must be held in debt securities (other than convertible debt securities and asset-backed securities). Securities that are servicing assets are not counted toward the 5% limit. This allows a bond bucket for collateralised loan obligations in order to increase their diversification and enable collateral managers to respond flexibly to changing market

5 17 C.F.R. § 275.203(l)-1.



conditions.

- Foreign public fund: Volcker Rule 2.0 ditched requirements that are inconsistent with the market practices so that foreign registered funds are generally found to be within the exclusion consistent with the original intention of the rule to treat them as similar to U.S. registered investment companies.

- Public welfare investment fund: The scope of qualifying welfare investment funds is expanded to include, e.g. qualified opportunity funds.

- Permitted activities of qualifying foreign excluded funds: One unintended consequence of the covered fund rule as originally adopted was that an investment fund that is organised and offered outside of the United States could still become subject to Volcker Rule's prohibitions on proprietary trading and other restrictions. Volcker Rule 2.0 expressly provides exemptions for activities of qualifying foreign excluded funds that are organised, offered, and sold outside the United States as part of a bona fide asset management business where the fund is not operated so as to evade the Volcker Rule. Thus, a foreign banking entity may acquire, retain or sponsor a qualifying foreign excluded fund by relying on the so-called 'SOTUS' exemption (permitted covered fund activities and investments outside the United States).

Conclusion

With the expiration of the CRA review period, a cloud of uncertainty over the alternative investment management industry has lifted and floated away. Now, instead of worrying about whether Volcker Rule 2.0 is a valid regulation, investment managers are free to structure new and existing funds to conform to the new exclusions or take advantage of the new flexibility in existing exclusions. It will also permit alternative investment managers to focus with renewed intensity on some of the points of ambiguity in the Volcker Rule 2.0 that may be a fruitful source of interpretive guidance through FAQs or otherwise.