



The Final Volcker Rule:

What Private Fund Managers
Not Affiliated with a Bank
Need to Know

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One Rule/Two Parts

- **Restricts:**
 - Proprietary trading
 - Private investment fund activities

Fund Activities Part: Two Subparts

- **Restricts:**
 - Fund sponsorship
 - Fund investments

To Whom Does the Volcker Rule Apply?

- **Applies to “banking entities”:**
 - All U.S. banks and their affiliates*
 - Non-U.S. banks and their affiliates*
 - U.S. branch or agency office or subsidiary commercial lending company in the U.S.

***Except affiliated “covered funds,” “portfolio companies” and “portfolio concerns.” Since covered funds are not affiliates, fund of funds or feeder funds controlled by a banking entity are not subject to the Volcker Rule**

Banking Entities as Fund Investors

- **In general, the Rule prohibits a banking entity from:**
 - Acquiring or retaining, “as principal,”
 - An “ownership interest”
 - In a “covered fund”

What is a “Covered Fund”?

- **Funds that rely on 3(c)(1) or 3(c)(7) of the '40 Act**
- **Commodity pool equivalents**
- **Equivalent non-U.S. Funds**
 - Only if banking entity is U.S. or U.S.-controlled

Exclusions from the Definition of a “Covered Fund”

- **Registered funds**
- **Certain non-U.S. public funds**
- **Certain non-funds**
- **Foreign pension funds**
- **Insurance company separate accounts**
- **Bank-Owned life insurance**
- **Loan securitizations**
- **Certain asset-backed commercial paper conduits**
- **Qualifying covered bonds**
- **SBICs and public welfare investment funds**
- **FDIC-Related issuers**

What are “Ownership Interests”?

- **Equity, partnership or other interest with:**
 - Certain voting rights
 - Rights to income/profits, residual assets or excess spread
 - Interest, income or rate of return tied to performance of underlying assets of fund
- **Does not include restricted profits interests earned as performance compensation (e.g., carried interest)**
 - Allows banking entities to continue to manage their own funds, provide advisory services to third-party funds and/or share in the economics of a third-party manager

When is a Banking Entity Acting “As Principal”?

- **Does not apply to acting:**
 - In the ordinary course of collecting on a debt (i.e., foreclosing on fund shares pledged as collateral)
 - Solely as agent, broker or custodian
 - As trustee or in a similar fiduciary capacity
 - Through bank-affiliated deferred comp, stock-bonus, or pension plans

Exceptions to the Prohibition

- **Funds “organized and offered”* by the banking entity**
 - Per fund limit
 - 3% De Minimis exception
 - 100% Seeding exception
 - Aggregate limit (3% of Tier 1 capital)

***A banking entity will be deemed to “organize and offer” a third-party fund if it acts as sub-advisor, distributor, or broker to the fund**

Exceptions to the Prohibition (Cont'd)

- **Investments in covered funds made “solely outside the U.S.”**
 - Eligible non-U.S. Banking entities
 - Eligible covered funds
 - Eligible activity
- **Insurance company investments in covered funds**
- **Underwriting and market making in covered funds**
- **Risk-mitigation hedging**
 - Final Rule eliminated ability to hedge risk associated with facilitating client exposure to a fund

Other Investor Relationships with Banking Entities

- **Banking entity as:**
 - Owner of managed account
 - Co-investor in portfolio company
- **Investor in management company**

Non-Investor Relationships with Banking Entities

- **Banking entity as:**
 - Prime broker
 - Execution broker
 - Distributer/placement agent
 - Lender to fund
 - Lender to investor (secured by fund shares)
 - Lender to portfolio company

What Restrictions Apply to a Banking Entity's Transactions with Covered Funds?

- **Restrictions only apply to transactions with any fund “organized and offered”:**
 - Prohibited transactions with fund (“Super 23A”)
 - Loans and other extensions of credit to fund
 - Purchases of fund securities (other than as permitted)
 - Purchases of fund assets
 - Guarantees, acceptances or letters of credit on behalf of fund
 - Certain securities lending, securities borrowing or derivative transactions with fund
 - Potential exception for “prime brokerage transactions” with secondary fund
 - Market terms requirement (“Section 23B”)

Timing

- **Conformance date**
- **Conformance period obligations**
- **Potential extensions**

Speaker Biographies



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David Nissenbaum is a partner in the New York office and a member of the firm's Executive Committee. His practice focuses on corporate, bank regulation and securities matters and he primarily represents institutional and entrepreneurial investment managers, financial services firms and private investment funds in all aspects of their business. David structures and advises investment management and financial services firms as well as hedge, private equity and hybrid funds, funds of funds and scalable platforms for fund sponsors. He also advises on succession planning, mergers and acquisitions of investment firms and on all aspects of U.S. banking laws that affect investment and financial services firms and investment funds, including investments in banking organizations and bank-sponsored funds and investments in funds by banking organizations.

A member of the Advisory Board of The Financial Executives Alliance and past member of the Banking Law Committee of the New York City Bar Association, David is a sought-after writer and speaker in his areas of expertise. "Just Like Starting Over: A Blueprint for the New Wall Street Firm," published by *The Deal*, "Hedge Fund Manager Succession Planning" and "Federal Reserve Provides Greater Flexibility for Non-Controlling Investment in Banks and Bank Holding Companies" are among his publications, and he also co-authored *Hedge Funds: Formation, Operation and Regulation*, published by ALM Law Journal Press. He spoke on "What's Market Practice? Are You Competitive?" at SRZ and McLagan's Pay Design Within Hedge Funds. David has been recognized by *The International Who's Who of Private Funds Lawyers*, *PLC Cross-border Private Equity Handbook*, *The Legal 500 United States*, *IFLR Guide to the World's Leading Investment Funds Lawyers*, *Chambers USA* and *Chambers Global*.

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Joseph P. Vitale is a partner in both the New York and Washington, D.C. offices. His practice focuses on representing financial institutions with respect to: chartering; regulatory compliance; financial transactions; mergers, acquisitions and reorganizations; formal and informal regulatory actions; litigations and claims; and legislative and regulatory developments. Joseph also advises parties, including private investment funds, seeking to invest in or acquire banks or other licensed financial service providers. He practices before the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Federal Housing Finance Agency, and the banking agencies of all 50 states, the District of Columbia and Puerto Rico. Joseph is recognized by *Chambers USA*, *IFLR 1000*, *The Legal 500 United States* and *New York Super Lawyers* as one of the nation's leading lawyers for both banking compliance and financial institutions M&A work. *Chambers* noted that clients give him "strong reviews for his broad regulatory practice," in particular his "knowledge of the regulatory environment," "substantive technical knowledge and good advocacy skills," and claim that "his advice stands the test of time." *The Legal 500* indicates that clients find him to be "impressive," particularly on "matters at the intersection between the private equity and banking worlds."

Highlights of Joseph's practice include representing the majority owners of a Fortune 100 mortgage and consumer finance conglomerate in connection with the institution's conversion into the nation's 14th largest bank holding company, a complex transaction that included a related \$2 billion private recapitalization and the acquisition of \$5 billion in public funds through the TARP; and his representation of both the seller (a private investment firm) and the buyer (one of the 15 largest banks in the U.S.) in the \$6.2 billion sale of a national consumer finance company, including obtaining more than 100 government approvals necessary to close the transaction. Other practice highlights include advising the nation's largest Internet retailer on the creation of its online money transmission and payments business. Joseph is admitted to federal and state courts for the District of Columbia and the State of New York as well as the U.S. Court of Federal Claims, where, among other matters, he co-litigated a breach-of-contract claim on behalf of a former thrift institution which, after an eight-week trial, resulted in a \$96 million judgment against the U.S. government.