

EFFECTIVE DATE

Section effective 1 day after July 21, 2010, except as otherwise provided, see section 4 of Pub. L. 111-203, set out as a note under section 5301 of this title.

DEFINITIONS

For definitions of terms used in this section, see section 5301 of this title.

§ 1851. Prohibitions on proprietary trading and certain relationships with hedge funds and private equity funds

(a) In general

(1) Prohibition

Unless otherwise provided in this section, a banking entity shall not—

(A) engage in proprietary trading; or

(B) acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.

(2) Nonbank financial companies supervised by the Board

Any nonbank financial company supervised by the Board that engages in proprietary trading or takes or retains any equity, partnership, or other ownership interest in or sponsors a hedge fund or a private equity fund shall be subject, by rule, as provided in subsection (b)(2), to additional capital requirements for and additional quantitative limits with regards to such proprietary trading and taking or retaining any equity, partnership, or other ownership interest in or sponsorship of a hedge fund or a private equity fund, except that permitted activities as described in subsection (d) shall not be subject to the additional capital and additional quantitative limits except as provided in subsection (d)(3), as if the nonbank financial company supervised by the Board were a banking entity.

(b) Study and rulemaking

(1) Study

Not later than 6 months after July 21, 2010, the Financial Stability Oversight Council shall study and make recommendations on implementing the provisions of this section so as to—

(A) promote and enhance the safety and soundness of banking entities;

(B) protect taxpayers and consumers and enhance financial stability by minimizing the risk that insured depository institutions and the affiliates of insured depository institutions will engage in unsafe and unsound activities;

(C) limit the inappropriate transfer of Federal subsidies from institutions that benefit from deposit insurance and liquidity facilities of the Federal Government to unregulated entities;

(D) reduce conflicts of interest between the self-interest of banking entities and nonbank financial companies supervised by the Board, and the interests of the customers of such entities and companies;

(E) limit activities that have caused undue risk or loss in banking entities and nonbank financial companies supervised by the Board, or that might reasonably be expected

to create undue risk or loss in such banking entities and nonbank financial companies supervised by the Board;

(F) appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system; and

(G) appropriately time the divestiture of illiquid assets that are affected by the implementation of the prohibitions under subsection (a).

(2) Rulemaking

(A) In general

Unless otherwise provided in this section, not later than 9 months after the completion of the study under paragraph (1), the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, shall consider the findings of the study under paragraph (1) and adopt rules to carry out this section, as provided in subparagraph (B).

(B) Coordinated rulemaking

(i) Regulatory authority

The regulations issued under this paragraph shall be issued by—

(I) the appropriate Federal banking agencies, jointly, with respect to insured depository institutions;

(II) the Board, with respect to any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act,¹ any nonbank financial company supervised by the Board, and any subsidiary of any of the foregoing (other than a subsidiary for which an agency described in subclause (I), (III), or (IV) is the primary financial regulatory agency);

(III) the Commodity Futures Trading Commission, with respect to any entity for which the Commodity Futures Trading Commission is the primary financial regulatory agency, as defined in section 5301 of this title; and

(IV) the Securities and Exchange Commission, with respect to any entity for which the Securities and Exchange Commission is the primary financial regulatory agency, as defined in section 5301 of this title.

(ii) Coordination, consistency, and comparability

In developing and issuing regulations pursuant to this section, the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall consult and coordinate with each other, as appropriate, for the purposes of assuring,

¹ See References in Text note below.

to the extent possible, that such regulations are comparable and provide for consistent application and implementation of the applicable provisions of this section to avoid providing advantages or imposing disadvantages to the companies affected by this subsection and to protect the safety and soundness of banking entities and nonbank financial companies supervised by the Board.

(iii) Council role

The Chairperson of the Financial Stability Oversight Council shall be responsible for coordination of the regulations issued under this section.

(c) Effective date

(1) In general

Except as provided in paragraphs (2) and (3), this section shall take effect on the earlier of—

- (A) 12 months after the date of the issuance of final rules under subsection (b); or
- (B) 2 years after July 21, 2010.

(2) Conformance period for divestiture

A banking entity or nonbank financial company supervised by the Board shall bring its activities and investments into compliance with the requirements of this section not later than 2 years after the date on which the requirements become effective pursuant to this section or 2 years after the date on which the entity or company becomes a nonbank financial company supervised by the Board. The Board may, by rule or order, extend this two-year period for not more than one year at a time, if, in the judgment of the Board, such an extension is consistent with the purposes of this section and would not be detrimental to the public interest. The extensions made by the Board under the preceding sentence may not exceed an aggregate of 3 years.

(3) Extended transition for illiquid funds

(A) Application

The Board may, upon the application of a banking entity, extend the period during which the banking entity, to the extent necessary to fulfill a contractual obligation that was in effect on May 1, 2010, may take or retain its equity, partnership, or other ownership interest in, or otherwise provide additional capital to, an illiquid fund.

(B) Time limit on approval

The Board may grant 1 extension under subparagraph (A), which may not exceed 5 years.

(4) Divestiture required

Except as otherwise provided in subsection (d)(1)(G), a banking entity may not engage in any activity prohibited under subsection (a)(1)(B) after the earlier of—

- (A) the date on which the contractual obligation to invest in the illiquid fund terminates; and
- (B) the date on which any extensions granted by the Board under paragraph (3) expire.

(5) Additional capital during transition period

Notwithstanding paragraph (2), on the date on which the rules are issued under subsection (b)(2), the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall issue rules, as provided in subsection (b)(2), to impose additional capital requirements, and any other restrictions, as appropriate, on any equity, partnership, or ownership interest in or sponsorship of a hedge fund or private equity fund by a banking entity.

(6) Special rulemaking

Not later than 6 months after July 21, 2010, the Board shall issue rules to implement paragraphs (2) and (3).

(d) Permitted activities

(1) In general

Notwithstanding the restrictions under subsection (a), to the extent permitted by any other provision of Federal or State law, and subject to the limitations under paragraph (2) and any restrictions or limitations that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, may determine, the following activities (in this section referred to as “permitted activities”) are permitted:

(A) The purchase, sale, acquisition, or disposition of obligations of the United States or any agency thereof, obligations, participations, or other instruments of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.), and obligations of any State or of any political subdivision thereof.

(B) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) in connection with underwriting or market-making-related activities, to the extent that any such activities permitted by this subparagraph are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.

(C) Risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(D) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers.

(E) Investments in one or more small business investment companies, as defined in section 102¹ of the Small Business Investment Act of 1958 (15 U.S.C. 662), investments

designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 24 of this title, or investments that are qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of title 26 or a similar State historic tax credit program.

(F) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company, if—

(i) the purchase, sale, acquisition, or disposition is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which each such insurance company is domiciled; and

(ii) the appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and territories of the United States, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in clause (i) is insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States.

(G) Organizing and offering a private equity or hedge fund, including serving as a general partner, managing member, or trustee of the fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the fund, including any necessary expenses for the foregoing, only if—

(i) the banking entity provides bona fide trust, fiduciary, or investment advisory services;

(ii) the fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, or investment advisory services and only to persons that are customers of such services of the banking entity;

(iii) the banking entity does not acquire or retain an equity interest, partnership interest, or other ownership interest in the funds except for a de minimis investment subject to and in compliance with paragraph (4);

(iv) the banking entity complies with the restrictions under paragraphs (1) and (2) of subparagraph (f);

(v) 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;

(vi) the banking entity does not share with the hedge fund or private equity fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name;

(vii) no director or employee of the banking entity takes or retains an equity interest, partnership interest, or other ownership interest in the hedge fund or private equity fund, except for any director or employee of the banking entity who is directly engaged in providing investment advisory or other services to the hedge fund or private equity fund; and

(viii) the banking entity discloses to prospective and actual investors in the fund, in writing, that any losses in such hedge fund or private equity fund are borne solely by investors in the fund and not by the banking entity, and otherwise complies with any additional rules of the appropriate Federal banking agencies, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, as provided in subsection (b)(2), designed to ensure that losses in such hedge fund or private equity fund are borne solely by investors in the fund and not by the banking entity.

(H) Proprietary trading conducted by a banking entity pursuant to paragraph (9) or (13) of section 1843(c) of this title, provided that the trading occurs solely outside of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

(I) The acquisition or retention of any equity, partnership, or other ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity pursuant to paragraph (9) or (13) of section 1843(c) of this title solely outside of the United States, provided that no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

(J) Such other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine, by rule, as provided in subsection (b)(2), would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

(2) Limitation on permitted activities

(A) In general

No transaction, class of transactions, or activity may be deemed a permitted activity under paragraph (1) if the transaction, class of transactions, or activity—

(i) would involve or result in a material conflict of interest (as such term shall be defined by rule as provided in subsection (b)(2)) between the banking entity and its clients, customers, or counterparties;

(ii) would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies (as such terms shall be defined by rule as provided in subsection (b)(2));

(iii) would pose a threat to the safety and soundness of such banking entity; or

(iv) would pose a threat to the financial stability of the United States.

(B) Rulemaking

The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall issue regulations to implement subparagraph (A), as part of the regulations issued under subsection (b)(2).

(3) Capital and quantitative limitations

The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall, as provided in subsection (b)(2), adopt rules imposing additional capital requirements and quantitative limitations, including diversification requirements, regarding the activities permitted under this section if the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine that additional capital and quantitative limitations are appropriate to protect the safety and soundness of banking entities engaged in such activities.

(4) De minimis investment

(A) In general

A banking entity may make and retain an investment in a hedge fund or private equity fund that the banking entity organizes and offers, subject to the limitations and restrictions in subparagraph (B) for the purposes of—

(i) establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors; or

(ii) making a de minimis investment.

(B) Limitations and restrictions on investments

(i) Requirement to seek other investors

A banking entity shall actively seek unaffiliated investors to reduce or dilute the investment of the banking entity to the amount permitted under clause (ii).

(ii) Limitations on size of investments

Notwithstanding any other provision of law, investments by a banking entity in a hedge fund or private equity fund shall—

(I) not later than 1 year after the date of establishment of the fund, be reduced through redemption, sale, or dilution to an amount that is not more than 3 percent of the total ownership interests of the fund;

(II) be immaterial to the banking entity, as defined, by rule, pursuant to subsection (b)(2), but in no case may the aggregate of all of the interests of the

banking entity in all such funds exceed 3 percent of the Tier 1 capital of the banking entity.

(iii) Capital

For purposes of determining compliance with applicable capital standards under paragraph (3), the aggregate amount of the outstanding investments by a banking entity under this paragraph, including retained earnings, shall be deducted from the assets and tangible equity of the banking entity, and the amount of the deduction shall increase commensurate with the leverage of the hedge fund or private equity fund.

(C) Extension

Upon an application by a banking entity, the Board may extend the period of time to meet the requirements under subparagraph (B)(ii)(I) for 2 additional years, if the Board finds that an extension would be consistent with safety and soundness and in the public interest.

(e) Anti-evasion

(1) Rulemaking

The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall issue regulations, as part of the rulemaking provided for in subsection (b)(2), regarding internal controls and recordkeeping, in order to insure compliance with this section.

(2) Termination of activities or investment

Notwithstanding any other provision of law, whenever an appropriate Federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, as appropriate, has reasonable cause to believe that a banking entity or nonbank financial company supervised by the Board under the respective agency's jurisdiction has made an investment or engaged in an activity in a manner that functions as an evasion of the requirements of this section (including through an abuse of any permitted activity) or otherwise violates the restrictions under this section, the appropriate Federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, as appropriate, shall order, after due notice and opportunity for hearing, the banking entity or nonbank financial company supervised by the Board to terminate the activity and, as relevant, dispose of the investment. Nothing in this paragraph shall be construed to limit the inherent authority of any Federal agency or State regulatory authority to further restrict any investments or activities under otherwise applicable provisions of law.

(f) Limitations on relationships with hedge funds and private equity funds

(1) In general

No banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund, or that organizes and of-

fers a hedge fund or private equity fund pursuant to paragraph (d)(1)(G), and no affiliate of such entity, may enter into a transaction with the fund, or with any other hedge fund or private equity fund that is controlled by such fund, that would be a covered transaction, as defined in section 371c of this title, with the hedge fund or private equity fund, as if such banking entity and the affiliate thereof were a member bank and the hedge fund or private equity fund were an affiliate thereof.

(2) Treatment as member bank

A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund, or that organizes and offers a hedge fund or private equity fund pursuant to paragraph (d)(1)(G), shall be subject to section 371c-1 of this title, as if such banking entity were a member bank and such hedge fund or private equity fund were an affiliate thereof.

(3) Permitted services

(A) In general

Notwithstanding paragraph (1), the Board may permit a banking entity to enter into any prime brokerage transaction with any 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 equity, partnership, or other ownership interest, if—

(i) the banking entity is in compliance with each of the limitations set forth in subsection (d)(1)(G) with regard to a hedge fund or private equity fund organized and offered by such banking entity;

(ii) the chief executive officer (or equivalent officer) of the banking entity certifies in writing annually (with a duty to update the certification if the information in the certification materially changes) that the conditions specified in subsection (d)(1)(g)(v)² are satisfied; and

(iii) the Board has determined that such transaction is consistent with the safe and sound operation and condition of the banking entity.

(B) Treatment of prime brokerage transactions

For purposes of subparagraph (A), a prime brokerage transaction described in subparagraph (A) shall be subject to section 371c-1 of this title as if the counterparty were an affiliate of the banking entity.

(4) Application to nonbank financial companies supervised by the Board

The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall adopt rules, as provided in subsection (b)(2), imposing additional capital charges or other restrictions for nonbank financial companies supervised by the Board to address the risks to and conflicts of interest of banking entities described in paragraphs (1), (2), and (3) of this subsection.

(g) Rules of construction

(1) Limitation on contrary authority

Except as provided in this section, notwithstanding any other provision of law, the prohibitions and restrictions under this section shall apply to activities of a banking entity or nonbank financial company supervised by the Board, even if such activities are authorized for a banking entity or nonbank financial company supervised by the Board.

(2) Sale or securitization of loans

Nothing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law.

(3) Authority of Federal agencies and State regulatory authorities

Nothing in this section shall be construed to limit the inherent authority of any Federal agency or State regulatory authority under otherwise applicable provisions of law.

(h) Definitions

In this section, the following definitions shall apply:

(1) Banking entity

The term “banking entity” means any insured depository institution (as defined in section 1813 of this title), any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity. For purposes of this paragraph, the term “insured depository institution” does not include an institution that functions solely in a trust or fiduciary capacity, if—

(A) all or substantially all of the deposits of such institution are in trust funds and are received in a bona fide fiduciary capacity;

(B) no deposits of such institution which are insured by the Federal Deposit Insurance Corporation are offered or marketed by or through an affiliate of such institution;

(C) such institution does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others or make commercial loans; and

(D) such institution does not—

(i) obtain payment or payment related services from any Federal Reserve bank, including any service referred to in section 248a of this title; or

(ii) exercise discount or borrowing privileges pursuant to section 461(b)(7) of this title.

(2) Hedge fund; private equity fund

The terms “hedge fund” and “private equity fund” mean an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act [15 U.S.C. 80a-3(c)(1), (7)], or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the

² So in original. Probably should be “(d)(1)(G)(v)”.

Commodity Futures Trading Commission may, by rule, as provided in subsection (b)(2), determine.

(3) Nonbank financial company supervised by the Board

The term “nonbank financial company supervised by the Board” means a nonbank financial company supervised by the Board of Governors, as defined in section 5311 of this title.

(4) Proprietary trading

The term “proprietary trading”, when used with respect to a banking entity or nonbank financial company supervised by the Board, means engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board 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 agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule as provided in subsection (b)(2), determine.

(5) Sponsor

The term to “sponsor” a fund means—

(A) to serve as a general partner, managing member, or trustee of a fund;

(B) in any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a fund; or

(C) to share with a fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.

(6) Trading account

The term “trading account” means any account used for acquiring or taking positions in the securities and instruments described in paragraph (4) principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule as provided in subsection (b)(2), determine.

(7) Illiquid fund

(A) In general

The term “illiquid fund” means a hedge fund or private equity fund that—

(i) as of May 1, 2010, was principally invested in, or was invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments; and

(ii) makes all investments pursuant to, and consistent with, an investment strategy to principally invest in illiquid assets.

In issuing rules regarding this subparagraph, the Board shall take into consideration the terms of investment for the hedge fund or private equity fund, including contractual obligations, the ability of the fund to divest of assets held by the fund, and any other factors that the Board determines are appropriate.

(B) Hedge fund

For the purposes of this paragraph, the term “hedge fund” means any fund identified under subsection (h)(2), and does not include a private equity fund, as such term is used in section 80b-3(m) of title 15.

(May 9, 1956, ch. 240, §13, as added Pub. L. 111-203, title VI, §619, July 21, 2010, 124 Stat. 1620.)

REFERENCES IN TEXT

Section 8 of the International Banking Act, referred to in subsec. (b)(2)(B)(i)(II), probably means section 8 of Pub. L. 95-369, known as the International Banking Act of 1978, which enacted section 3106 of this title and amended section 1841 of this title.

The Farm Credit Act of 1971, referred to in subsec. (d)(1)(A), is Pub. L. 92-181, Dec. 10, 1971, 85 Stat. 583, which is classified principally to chapter 23 (§2001 et seq.) of this title. For complete classification of this Act to the Code, see Short Title note set out under section 2001 of this title and Tables.

Section 102 of the Small Business Investment Act of 1958, referred to in subsec. (d)(1)(E), probably should be section 103 of the Small Business Investment Act of 1958, which is classified to section 662 of Title 15, Commerce and Trade.

Section 8 of the International Banking Act of 1978, referred to in subsec. (h)(1), is section 8 of Pub. L. 95-369, which enacted section 3106 of this title and amended section 1841 of this title.

The Investment Company Act of 1940, referred to in subsec. (h)(2), is title I of act Aug. 22, 1940, ch. 686, 54 Stat. 789, which is classified generally to subchapter I (§80a-1 et seq.) of chapter 2D of Title 15, Commerce and Trade. For complete classification of this Act to the Code, see section 80a-51 of Title 15 and Tables.

EFFECTIVE DATE

Section effective 1 day after July 21, 2010, except as otherwise provided, see section 4 of Pub. L. 111-203, set out as a note under section 5301 of this title.

§ 1852. Concentration limits on large financial firms

(a) Definitions

In this section—

(1) the term “Council” means the Financial Stability Oversight Council;

(2) the term “financial company” means—

(A) an insured depository institution;

(B) a bank holding company;

(C) a savings and loan holding company;

(D) a company that controls an insured depository institution;

(E) a nonbank financial company supervised by the Board under title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act [12 U.S.C. 5311 et seq.]; and

(F) a foreign bank or company that is treated as a bank holding company for purposes of this chapter; and

(3) the term “liabilities” means—

(A) with respect to a United States financial company—