

RESTRICTIONS ON AFFILIATE TRANSACTIONS

The Dodd-Frank Act imposes additional restrictions on transactions between affiliates by amending Section 23A and Section 23B of the Federal Reserve Act. Section 23A and Section 23B of the Federal Reserve Act establish parameters for a bank to conduct “covered transactions” with its affiliates, with the objective of limiting risk to the insured bank and preventing the insured bank at least from transferring to its affiliates the benefits of the bank’s access to the federal “safety net.” Section 23B requires market terms and conditions for “covered transactions” and certain other transactions with affiliates.

Changes to Section 23A

- **Affiliates**: The Dodd-Frank Act modifies the definition of “affiliate” in this context in order to include “any investment fund with respect to which a member bank or affiliate thereof is an investment adviser.”
- **Covered Transactions**: The Dodd-Frank Act expands the category of transactions that are considered “covered transactions,” and includes:
 - The acceptance of other debt obligations of an affiliate as collateral for a loan to a third party;
 - A “derivative transaction” with an affiliate to the extent that it creates a “credit exposure”; and
 - A transaction with an affiliate that involves borrowing or lending securities that creates a “credit exposure.”
- The term “credit exposure” is not defined. The Federal Reserve is authorized to define this term.

Collateral Requirements

The Dodd-Frank Act imposes additional collateral requirements in the case of:

- a repurchase agreement (which is considered an extension of credit), and
- a bank’s credit exposure in respect of derivatives transactions and borrowing/lending transactions with affiliates.

A credit extension or guarantee would be required to remain secured in accordance with Section 23A collateral requirements for so long as it is outstanding.

Qualitative Safeguards

The Dodd-Frank Act extends the prohibition on the acceptance of low-quality assets or securities issued by an affiliate as collateral for an extension of credit to or on behalf of an affiliate to derivatives and securities lending transactions.

Netting

The Federal Reserve is allowed to take into account netting agreements for derivatives and securities lending transactions if these are fully secured by U.S. government securities or segregated deposits held at a member bank.

Exemptive Authority

The banking regulators’ authority to grant exemptions for transactions under Section 23A and Section 23B will be more limited and subject to FDIC veto.

Effective Date

The changes to Section 23A and Section 23B described above will become effective one year after the transfer date.

Volcker Rule

Covered transactions (as defined in Section 23A) are not permitted whenever a banking entity or its affiliate serves, directly or indirectly, as the investment manager, adviser or sponsor to a hedge fund or a private equity fund, or provides “custody, securities lending or other prime brokerage services” to such a fund. Transactions between banking entities and their managed, advised or sponsored funds will be required to occur on an arm’s-length basis pursuant to the requirements of Section 23B.