June 5, 2018

Volcker Rule

Federal Banking Agencies and CFTC Approve Notice of Proposed Rulemaking to Amend Volcker Rule Regulations; SEC Expected to Follow

EXECUTIVE SUMMARY

On May 30, 2018, the Board of Governors of the Federal Reserve System (the "Federal Reserve") approved a notice of proposed rulemaking to amend the regulations implementing the so-called "Volcker Rule" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Each of the other agencies responsible for implementing and enforcing the Volcker Rule (collectively with the Federal Reserve, the "Agencies")[1] subsequently approved or is expected to approve in the very near term a substantially similar notice of proposed rulemaking (collectively with the Federal Reserve's notice of proposed rulemaking, the "NPR").[2]

The NPR follows recent statements by representatives of the Agencies,[3] a 2017 report on financial reform by the U.S. Department of the Treasury[4] (the "Treasury Report") and a public comment process initiated by the OCC[5] (the "OCC RFI") following the Treasury Report, each of which highlighted concerns that the current Volcker Rule regulations are overly complex and should be tailored to reduce compliance costs and clarify the application of the regulations. The NPR also comes shortly after Congress's May 24, 2018 enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Reform Act"), which exempts certain smaller banking entities from the Volcker Rule entirely.[6]

We believe that there are two key takeaways from the NPR:

- First, the NPR proposes limited and targeted changes to the proprietary trading and compliance program provisions of the Volcker Rule regulations and, to a significantly lesser extent, the covered funds provisions. The Agencies' stated objectives for these changes include streamlining and clarifying the application of their regulations and tailoring the compliance program and certain other requirements based on the size and scope of a banking entity's trading activities. For example, a banking entity with less than $10 billion in gross trading assets and liabilities would be

subject to a substantially simpler compliance program requirement than a banking entity that exceeds this threshold, and banking entities with less than $1 billion in gross trading assets and liabilities would benefit from a "presumption of compliance" with all aspects of the regulations. If adopted in the form proposed in the NPR, however, the amendments would provide a lesser degree of relief to the firms most affected by the Volcker Rule, including larger and mid-sized banking entities. Furthermore, the proposed changes to the proprietary trading provisions will need to be carefully analyzed by individual banking organizations in order to assess the impact on their businesses and operations.

- Second, many recommendations and concerns raised in the Treasury Report, the OCC RFI and industry comment letters[7]—especially with respect to the covered funds provisions—are not addressed in any proposed amendment but instead are discussed only in certain of the 342 separately numbered questions (and multiple subquestions) posed in the preamble to the NPR's proposed amendments (the "Preamble").

The ultimate scope and contour of many significant aspects of the Volcker Rule regulations remain open questions and should be influenced by the comment process that will follow publication of the NPR. Comments on the NPR will be due 60 days following publication in the *Federal Register*.

A comparison of the text of the Agencies' final rule issued on December 10, 2013 (the "2013 Rule")[8] against the text of the amended regulations proposed by the NPR (the "Proposed Rule") is attached as **Appendix A** to this Memorandum.

OVERVIEW

The Volcker Rule, as implemented by the 2013 Rule, imposes broad prohibitions on proprietary trading and investing in and sponsoring private equity funds, hedge funds and certain other investment vehicles—referred to as "covered funds" in the 2013 Rule—by banking entities. In addition, banking entities are generally required to establish an internal compliance program that is reasonably designed to ensure and monitor compliance with the Volcker Rule.[9] The Proposed Rule is the Agencies' first proposal to amend the 2013 Rule,[10] although staffs of the Agencies have published a number of "Frequently Asked Questions" (FAQs) to provide interpretive guidance[11] and have also issued policy statements and other guidance regarding the application and interpretation of various aspects of the 2013 Rule.[12]

As the Agencies acknowledge in the NPR, the 2013 Rule has been criticized for instituting an overly complex and prescriptive compliance regime that has led to difficulties for banking entities seeking to distinguish permissible from prohibited activities and created unnecessary compliance costs.[13] The Agencies state in the NPR that their proposal "would adopt a revised risk-based approach that would rely on a set of clearly articulated standards for both prohibited and permitted activities and investments, consistent with the requirements of [the Volcker Rule]."[14] In particular, the Agencies indicate that their proposal is intended to: (i) tailor the application of the regulations based on the size and scope of a banking entity's trading activities; (ii) streamline and clarify for all banking entities certain definitions and

requirements related to the proprietary trading prohibition and limitations on covered fund activities and investments—including by codifying or otherwise addressing matters that previously have been clarified through interagency FAQs and other guidance—and (iii) reduce metrics reporting, recordkeeping and compliance program requirements for all banking entities.[15]

Summarized below is an overview of key aspects of the NPR and the Proposed Rule:

A. TAILORING OF REQUIREMENTS; SCOPE OF APPLICABILITY

- ***Tailoring by amount of trading assets and liabilities.*** The Proposed Rule divides banking entities into three categories, each of which is subject to different compliance program and other requirements. The categorization applied to a banking entity is based on the extent of the banking entity's trading assets and liabilities—and does not also take into account total consolidated assets, unlike the 2013 Rule's approach to designating five tiers of compliance program requirements[16]—as calculated in the manner detailed in Part I of this Memorandum. The result of this calculation determines whether the banking entity is categorized as having trading assets and liabilities that are:[17]
  - "significant" (*i.e.*, ***equaling or exceeding a $10 billion threshold***), in which case the banking entity is subject to the "six-pillar" compliance program requirement, a quantitative trading metrics reporting and recordkeeping regime, specific compliance program requirements associated with the exemptions for underwriting and market making-related activities, documentation requirements associated with the risk-mitigating hedging exemption, covered fund documentation requirements and the CEO attestation requirement;
  - "moderate" (*i.e.*, ***between the $10 billion threshold and a $1 billion threshold***), in which case the banking entity is subject to reduced compliance program requirements and to the CEO attestation requirement; or
  - "limited" (*i.e.*, ***under the $1 billion threshold***), in which case the banking entity is subject to significantly reduced requirements, is presumed to be in compliance with the Proposed Rule and has no obligation to demonstrate compliance with the covered fund and proprietary trading provisions on an ongoing basis.
- ***Recent legislation exempting smaller, less active banking entities.*** The Reform Act exempts from the Volcker Rule entirely any banking entity that has (i) less than $10 billion in total consolidated assets and (ii) total trading assets and trading liabilities representing less than 5% of its total consolidated assets.[18] The NPR does not propose any implementation of the Reform Act's amendments, although it expressly states that the Agencies will not enforce the 2013 Rule in a manner inconsistent with those amendments.[19]

B. PROPRIETARY TRADING PROVISIONS

- ***"Trading account" tests.*** As under the 2013 Rule, the Proposed Rule provides a multi-prong test to determine whether a purchase of a financial instrument is "for the trading account" of the banking entity and is, therefore, within the definition of "proprietary trading." The Proposed Rule revises the 2013 Rule's definition of "trading account" by eliminating the "short-term intent prong" (including the 60-day rebuttable presumption) and adding a new "accounting prong" that generally captures any purchase or sale of a financial instrument that is recorded at fair value on a

recurring basis under applicable accounting standards. The Agencies note that this would include, among other financial instruments, derivatives, trading securities and available-for-sale securities. The Proposed Rule also includes a presumption of compliance for trading desks that are not captured by the "market risk capital prong" or the "dealer prong," so long as the trading desk operates at or below an absolute daily profit and loss threshold of $25 million (as calculated on a rolling basis with a 90-day lookback period).

- ***Definition of "trading desk."*** The Proposed Rule retains the current definition of "trading desk." However, the Agencies solicit comment on a potential multi-factor definition of "trading desk" that would be based on the same criteria typically used to establish trading desks for other operational, management and compliance purposes.

- ***Underwriting and market making-related activities.*** The Proposed Rule includes certain changes that are intended to "tailor, streamline, and clarify" the requirements that a banking entity must satisfy to avail itself of the exemptions for permitted underwriting and market making-related activities. Notably, a banking entity's purchase or sale of a financial instrument in connection with its underwriting or market making-related activities is presumed to meet the "reasonably expected near-term demands of clients, customers and counterparties" requirement ("RENTD") if the banking entity has established, and implements, maintains and enforces, the applicable "internally set risk limits." The Proposed Rule would also amend the compliance program requirement for each of these exemptions by making the requirement, in each case, applicable only to banking entities with significant trading assets and liabilities.

- ***Risk-mitigating hedging activities.*** The Proposed Rule streamlines certain conditions of the exemption for permitted risk-mitigating hedging activity by: (i) eliminating the current requirement that the hedging activity must demonstrably reduce or otherwise significantly mitigate one or more specific, identifiable risks; (ii) reducing documentation requirements associated with risk-mitigating hedging transactions that are conducted by one desk to hedge positions of another desk with pre-approved types of instruments within pre-set hedging limits; and (iii) eliminating the 2013 Rule's requirement that banking entities undertake correlation analyses regarding their hedges. The Proposed Rule provides for even more streamlined conditions for banking entities that do not have significant trading assets and liabilities.

- ***Exclusions for liquidity management activities and error trade exclusion.*** The Proposed Rule broadens the current liquidity management exclusion to allow banking entities to use foreign exchange forwards, foreign exchange swaps and physically settled cross-currency swaps as part of their liquidity management activities. Furthermore, the Proposed Rule establishes a new exclusion from the definition of "proprietary trading" for any purchase or sale of a financial instrument that was made in error by a banking entity in the course of conducting a permitted or excluded activity (or made to correct such an error).

- ***Trading by foreign banking entities outside of the United States.*** The Proposed Rule retains certain elements of the so-called "TOTUS" proprietary trading exemption (for trading activities conducted outside of the United States) while modifying or eliminating others. To qualify for the TOTUS exemption under the Proposed Rule, personnel engaged in the decision to purchase or sell the relevant financial instrument must not be located in the United States (the same requirement as under the 2013 Rule), among other conditions. However, the Proposed Rule removes the requirement that personnel who arrange, negotiate or execute such purchase or sale may not be located in the United States. Furthermore, the Proposed Rule removes the TOTUS exemption's "financing prong" (which requires that the purchase or sale not be financed by a U.S. affiliate or branch) and the "counterparty prong" (which requires that transactions with a

U.S. counterparty be executed through an unaffiliated market intermediary and promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty, and be conducted anonymously if the unaffiliated market intermediary is not acting as principal).

C. COVERED FUNDS PROVISIONS

- ***Definition of "covered fund."*** The Proposed Rule does not include specific changes to the definition of "covered fund," despite the Treasury Report's recommendation to adopt a simple definition that focuses on the characteristics of hedge funds and private equity funds, with appropriate additional exemptions,[20] comments in response to the OCC RFI that highlighted the overbreadth of the 2013 Rule's definition[21] and concerns acknowledged in the OCC RFI that the definition captures investment vehicles that facilitate lending activity and capital formation and that are not equivalent to traditional hedge funds or private equity funds.[22] The Agencies simply request comment on numerous aspects of the definition, including (i) whether the current definition effectively implements the statute and is appropriately tailored to identify the funds that are the intended focus of the Volcker Rule and (ii) whether the definition has been inappropriately imprecise and, if so, whether that has led to any unintended results.
- ***Exclusions from covered fund status.*** The Proposed Rule also retains without change the existing exclusions from the "covered fund" definition under the 2013 Rule. Comment is solicited broadly as to whether additional exclusions or modifications to the current exclusions would be appropriate, including for foreign public funds ("FPFs"), family wealth management vehicles, joint ventures, securitizations and municipal securities tender option bond vehicles.
- ***Banking entity status of foreign excluded funds.*** The Agencies solicit comment as to whether changes to the "covered fund" definition are warranted to address, among other issues, the possibility that entities excluded from the "covered fund" definition would nonetheless be treated as banking entities. These entities may include, for example, certain foreign excluded funds, with respect to which the NPR extends until July 21, 2019 the temporary relief from enforcement that the federal banking agencies previously provided (as explained further in Part II.B.1.ii below), as well as U.S. registered investment companies ("RICs"), FPFs and employees' securities companies. The Proposed Rule does not alter the current definition of "banking entity" under the 2013 Rule.
- ***"Super 23A" restrictions on relationships with certain covered funds.*** The Agencies specifically seek comment on whether the exemptions available under Section 23A of the Federal Reserve Act and Regulation W should also be available under the Volcker Rule, which generally prohibits a banking entity from entering into any transaction with related covered funds that would be a covered transaction as defined in Section 23A of the Federal Reserve Act. The Agencies also seek comment on whether to incorporate into the Super 23A provisions the quantitative limits on covered transactions in Section 23A of the Federal Reserve Act and Regulation W (in lieu of the current prohibition on covered transactions).
- ***Underwriting and market making for third-party covered funds.*** The Proposed Rule removes the requirement that a banking entity include in its aggregate funds limitation and Tier 1 capital deduction the value of any ownership interests in a covered fund acquired or retained under the underwriting or market making-related activities exemptions, so long as the banking entity does not sponsor or advise that covered fund.

- ***Risk-mitigating hedging investments for customer facilitation.*** The Proposed Rule would amend the 2013 Rule to allow a banking entity to acquire or retain a covered fund ownership interest as a risk-mitigating hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, subject to compliance with all the requirements of the covered funds exemption for permitted risk-mitigating hedging activity (as modified by the Proposed Rule). This proposal reverses the Agencies' position stated in the Supplementary Information accompanying the 2013 Rule that this type of activity constitutes a high-risk strategy that could threaten the safety and soundness of the banking entity.
- ***Permitted covered fund activities of a foreign banking entity.*** The Proposed Rule codifies the Agencies' previously issued FAQ guidance that, for purposes of the so-called "SOTUS" exemption (for covered fund activities and investments conducted "solely outside of the United States"), an ownership interest in a covered fund is not "offered for sale or sold to a resident of the United States" if it is not sold, and has not been sold, pursuant to an offering that targets residents of the United States in which the banking entity relying on the SOTUS exemption (or an affiliate) participates. Furthermore, the Proposed Rule eliminates the requirement in the 2013 Rule that no financing may be provided by any branch or affiliate of the banking entity in the United States for any sponsorship or investment conducted in reliance on the SOTUS exemption.

D. COMPLIANCE PROGRAM; QUANTITATIVE METRICS

- ***Compliance program.*** As noted in Part A of this Overview, the Proposed Rule's compliance program requirements are determined only by the extent of a banking entity's trading assets and liabilities (and not by reference to any other measure, such as the amount of total consolidated assets, which is a factor in determining the compliance program requirement applicable to a banking entity under the 2013 Rule). Banking entities are subject to one of three different compliance program tiers based on whether they have "significant trading assets and liabilities," "moderate trading assets and liabilities" or "limited trading assets and liabilities" (in each case, as defined in the Proposed Rule). Part I of this Memorandum provides a detailed explanation of this categorization and of the methodology to calculate trading assets and liabilities for this purpose.
- ***Metrics reporting and recordkeeping requirements.*** The Agencies indicate that they have assessed the utility of data gathered from banking entities' reports of quantitative trading metrics as well as the compliance costs of the metrics regime. Taking this evaluation into account, the Agencies propose numerous amendments to Appendix A of the 2013 Rule, including: (i) limiting the applicability of certain metrics only to market making and underwriting desks; (ii) replacing the Customer-Facing Trade Ratio with a new Transaction Volumes metric; (iii) replacing Inventory Turnover with a new Positions metric; (iv) eliminating inventory aging data for derivatives; (v) modifying the calculation and reporting methodology for certain metrics; and (vi) adding requirements that metrics-reporting banking entities provide (A) qualitative information regarding each trading desk, (B) a Narrative Statement describing changes in calculation methods, trading desk structure or trading desk strategies and (C) descriptive information about their reported metrics. As noted in Part A of this Overview, only banking entities with significant trading assets and liabilities are required to report quantitative trading metrics under the Proposed Rule.
- ***CEO attestation.*** Under the 2013 Rule, banking entities subject to the "enhanced" compliance program are required to provide an annual attestation of the chief executive officer that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program in a manner reasonably designed to achieve compliance with the rule. The

Proposed Rule retains the CEO attestation requirement and applies it to banking entities with significant trading assets and liabilities or moderate trading assets and liabilities. This change would extend the CEO attestation requirement to certain banking entities that are not subject to the "enhanced" compliance program under the 2013 Rule—for example, banking entities with less than $50 billion of total consolidated assets and less than $10 billion (but more than $1 billion) of trading assets and liabilities—but would exempt a banking entity with limited trading assets and liabilities from the requirement,[23] absent a determination by the Agencies to exercise its "reserved authority" to impose such requirement on the banking entity.[24]

The remainder of this Memorandum summarizes the significant provisions of the NPR and is organized as follows:

- Part I discusses the categorization of banking entities under the Proposed Rule, based on the amount of their trading assets and liabilities, and under the Reform Act.
- Part II provides a more detailed discussion of the Proposed Rule's changes to specific requirements and restrictions of the 2013 Rule.
- Part III provides an overview of areas on which the NPR solicits comment, including certain topics that are the subject of specific amendments in the Proposed Rule as well as a broad range of topics that are not addressed by any of these amendments.

TABLE OF CONTENTS

I. TAILORING OF THE PROPOSED RULE'S REQUIREMENTS

Under the 2013 Rule, a banking entity's total consolidated assets and its trading assets and liabilities (together with those of its affiliates and subsidiaries) determine the compliance program requirements that are applicable to the banking entity. Broadly speaking, the calculations of consolidated assets and trading assets and liabilities for this purpose are conducted either (i) on a worldwide basis in the case of U.S. banking entities or (ii) with respect to U.S. assets or combined U.S. operations in the case of foreign banking entities. Depending on these calculations, a banking entity is subject under the 2013 Rule to one of five different tiers of compliance program requirements, each of which entails a different set of required policies and procedures, recordkeeping, internal controls and other compliance program elements, as well as, potentially, quantitative metrics reporting and CEO attestation requirements.[25]

Under the Proposed Rule, banking entities are divided into three categories—each of which is subject to a distinct set of compliance program requirements and other substantive requirements, as summarized in Figure 1 below—based on the amount of the banking entities' trading assets and liabilities as calculated in the following manner (referred to as "TALs" in this Part I):

- In the case of a banking entity that is not and is not controlled by a foreign banking organization ("FBO"), the banking entity's TALS equals the average gross sum of the banking entity's and its affiliates' and subsidiaries' trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, on a worldwide consolidated basis.
- In the case of a banking entity that is a FBO or is controlled by a FBO, the calculation of TALs is based on the combined U.S. operations of the top-tier FBO (including all subsidiaries, affiliates, branches and agencies of the FBO operating, located or organized in the United States),[26] except that, for purposes of determining whether a FBO has "limited trading assets and liabilities" (*i.e.*, TALs of less than $1 billion) the calculation is conducted on a worldwide consolidated basis. Therefore, a FBO that has less than $1 billion in TALs based on the combined U.S. operations of the top-tier FBO but more than $1 billion in TALs on a worldwide consolidated basis would be deemed to have "moderate trading assets and liabilities."

In addition to the relief that the Proposed Rule provides for banking entities with "limited trading assets and liabilities"—*i.e.*, banking entities with TALs of less than $1 billion, calculated on a worldwide consolidated basis—Section 203 of the Reform Act exempts from the Volcker Rule any banking entity that has (i) less than $10 billion in total consolidated assets and (ii) total trading assets and trading liabilities representing less than 5% of its total consolidated assets. The Agencies indicate that they expect to conduct a separate rulemaking process to address the Reform Act's amendments that affect the Volcker Rule.[27] The Reform Act does not expressly state how "total trading assets and trading liabilities" for purposes of Section 203 should be determined, and the Preamble does not specify whether that figure will be calculated in the same manner as TALs.

The following table summarizes the categorization of banking entities under the Proposed Rule based on whether they have "significant trading assets and liabilities," "moderate trading assets and liabilities" or "limited trading assets and liabilities" (in each case, as defined in the Proposed Rule) and whether they are exempted from the Volcker Rule by Section 203 of the Reform Act.

Figure 1: Categorization of Banking Entities Under the Proposed Rule and the Reform Act

Categorization Under Proposed Rule / Reform Act	Criteria for This Level	Compliance Program Requirements	Metrics Reporting	CEO Attestation	Additional Permitted Activity Requirements
"Significant trading assets and liabilities"	TALs equal or exceed $10 billion. Calculation of TALs is based on (i) in the case of U.S. banking entities, all affiliates and subsidiaries on a worldwide basis and (ii) in the case of FBOs and their subsidiaries, combined U.S. operations only.	Six pillars required under the 2013 Rule (*i.e.*, written policies and procedures, internal controls, management framework, independent testing, training and records). Subject to the same additional covered fund documentation requirements as under the 2013 Rule.[28]	Yes. A banking entity with $50 billion or more in TALs is subject to increased frequency of reporting require-ments.	Yes.	Subject to compliance requirements in order to rely on exemptions for underwriting, market making-related and risk-mitigating hedging permitted activities.
"Moderate trading assets and liabilities"	TALs are less than $10 billion, but greater than or equal to the $1 billon threshold for banking entities with "limited" TALs (see below). TALs for U.S. banking entities and for FBOs and their subsidiaries are calculated as described immediately above.	Simplified compliance program requirement, which would "allow the banking entity to comply with the applicable requirements by updating existing policies and procedures."[29] Subject to the Agencies' "reserved authority" to require the banking entity to apply any requirement applicable to banking entities having "significant" TALs based on size or complexity of the entity's trading or investment activities, or the risk of evasion.[30]	No, unless notified in writing by the relevant Agency.	Yes.	--
"Limited trading assets and liabilities"	TALs are less than $1 billon (as calculated on a worldwide basis for all banking entities), and the banking entity is not otherwise exempted by the Reform Act (see below).	No compliance program requirement unless relevant Agency directs otherwise. Subject to the Agencies' "reserved authority" (see above) to require the banking entity to apply any requirement applicable to banking entities having "significant" or "moderate" TALs.[31] Presumed to be in compliance with substantive provisions (subject to rebuttal by an Agency upon an examination or audit).[32]	No, unless notified in writing by the relevant Agency.		--

Categorization Under Proposed Rule / Reform Act	Criteria for This Level	Compliance Program Requirements	Metrics Reporting	CEO Attestation	Additional Permitted Activity Requirements
Not engaged in covered activities	Does not engage in proprietary trading or covered fund activities (other than permitted trading in U.S. government obligations).	None, unless and until the banking entity becomes engaged in covered proprietary trading or covered fund activities.	No, unless notified in writing by the relevant Agency.		--
Exempted by the Reform Act	Banking entity has less than $10 billion in total consolidated assets; *and* total trading assets and liabilities representing less than 5% of its total consolidated assets.	Not subject to the Volcker Rule or any element of the Proposed Rule.			

II. CHANGES TO SPECIFIC REQUIREMENTS AND RESTRICTIONS

This Part II provides an overview of the provisions of the Proposed Rule that would substantively amend the 2013 Rule's requirements and restrictions. The following discussion focuses on the aspects of the Proposed Rule that would, if adopted, directly modify the regulatory requirements that banking entities must meet in order to comply with the Volcker Rule's restrictions on proprietary trading and covered fund activities (and to qualify for certain exemptions and exclusions) and to meet the Volcker Rule's compliance program requirement. The extent to which certain of these restrictions and requirements would apply to any particular banking entity under the Proposed Rule will depend on the banking entity's level of trading activities and the other factors explained in Part I of this Memorandum.

Many other aspects of the 2013 Rule that are not discussed in this Part II—including significant issues that have been the subject of extensive commentary among industry participants—are acknowledged in the Preamble as warranting further consideration and, potentially, further revisions to the 2013 Rule, but are not addressed in the Proposed Rule. Rather, these issues are addressed only in the NPR's questions and solicitations for comment, as discussed in Part III of this Memorandum.

II.A. PROPRIETARY TRADING

II.A.1. Definitions of "proprietary trading" and "trading account"

As under the 2013 Rule, determining whether a purchase or sale of a financial instrument is "proprietary trading" depends on whether the transaction is "for the trading account" of the banking entity. The 2013 Rule establishes a three-pronged test of "trading account" status: (i) the "short-term intent prong," which includes a rebuttable presumption that this prong captures any purchase or sale of a financial instrument if the banking entity holds the financial instrument for fewer than 60 days or substantially transfers the risk of the position within 60 days;[33] (ii) the "market risk capital prong";[34] and (iii) the "dealer prong."[35]

The Proposed Rule eliminates the "short-term intent prong," including the 60-day rebuttable presumption,[36] and establishes a modified version of this three-pronged test, as follows:[37]

- ***Market risk capital prong.*** As under this prong in the 2013 Rule, the "trading account" definition captures any purchase or sale of financial instruments that is both a market risk capital rule covered position and trading position (or a hedge of another market risk capital rule covered position) if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company or savings and loan holding company and calculates risk-based capital ratios under the market risk capital rule.[38]
    - The Proposed Rule modifies the market risk capital prong so that it would include, with respect to a banking entity that is not, and is not controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or any U.S. state,

any account used by the banking entity to purchase or sell one or more financial instruments that are subject to capital requirements under a market risk framework established by the home-country supervisor that is consistent with the market risk framework published by the Basel Committee on Banking Supervision.[39]

- ***Dealer prong.*** As under this prong in the 2013 Rule, the "trading account" definition captures any purchase or sale of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, to engage in the business of a dealer, swap dealer or security-based swap dealer, if the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such (or if the banking entity is engaged in the business of a dealer, swap dealer or security-based swap dealer outside of the United States, if the instrument is purchased or sold in connection with the activities of such business).[40]
- ***Accounting prong.*** The Proposed Rule establishes a new prong of the "trading account" definition (the "accounting prong") that captures any account used by a banking entity to purchase or sell one or more financial instruments that is recorded at fair value on a recurring basis under applicable accounting standards. The Agencies note that this would include, among other financial instruments, derivatives, trading securities and available-for-sale securities.[41]
  - The Proposed Rule includes a presumption of compliance with the proprietary trading prohibition for a trading desk[42] that purchases or sells financial instruments "for the trading account" *solely* by virtue of the accounting prong—in other words, a trading desk that is not captured by the market risk capital prong or the dealer prong. To qualify for this presumption, the trading desk must, in any 90-calendar-day period, operate at or below an absolute daily profit and loss threshold of $25 million—*i.e.*, the sum of the absolute values of the trading desk's daily net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments for the preceding 90-calendar-day period, does not exceed $25 million.[43]
  - The Agencies state that a banking entity that elects to make use of this presumption with respect to a trading desk would have no obligation to demonstrate that the trading desk's activity complies with the Volcker Rule on an ongoing basis so long as the $25 million threshold is not breached,[44] nor would the banking entity have to assess the accounting treatment of each transaction of a trading desk that operates pursuant to this presumption of compliance.[45]
  - If the trading desk's absolute daily profit and loss measurement exceeds $25 million at any point, then the banking entity would be required to notify the appropriate Agency in accordance with the Agency's notification policies and procedures.[46] Furthermore, the Proposed Rule reserves the Agencies' authority to determine on a case-by-case basis that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account, notwithstanding the presumption of compliance.[47]

In explaining the Proposed Rule's approach to revising or eliminating elements of the 2013 Rule's definition of "trading account" while retaining others, the Agencies observe that "[b]anking entities subject to the market risk capital prong and the dealer prong have had several years of experience complying with the requirements of the [2013 Rule] and experience with identifying these activities in other contexts," and such banking entities "are able to conduct appropriate trading activities in an efficient manner

pursuant to exclusions from the definition of proprietary trading or pursuant to the exemptions for permitted activities."[48]

The Agencies indicate that the inclusion of the accounting prong is "intended to give greater certainty and clarity . . . about what financial instruments would be included in the trading account, because banking entities should know which instruments are recorded at fair value on their balance sheets" and to provide an "objective means of ensuring that such positions entered into by banking entities principally for the purpose of selling in the near term, or with the intent to resell in order to profit from short-term price movements, are incorporated in the definition of trading account."[49] Individual firms should assess the impact of the accounting prong in their respective cases, including the possibility that it could include positions that are not within the trading account as defined under the 2013 Rule.

II.A.2. Definition of "trading desk"

Many of the substantive and compliance-related requirements for permitted proprietary trading under the 2013 Rule and the Proposed Rule are determined in relation to a banking entity's "trading desks." For example, compliance with the underwriting and market making-related activities exemptions (including the RENTD requirements for both such exemptions) is determined at the level of individual trading desks.[50] The Proposed Rule's presumption of compliance under the accounting prong (as discussed in Part II.A.1 above) requires trading desks operating pursuant to that presumption to calculate their profits and losses at the trading desk level and applies to all the activities of the trading desk.

The Proposed Rule retains the current definition of "trading desk"—that is, "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof."[51] The Agencies request comment on various alternatives to this definition of "trading desk," noting that banking entities have indicated that, in practice, this definition has led to uncertainty regarding the meaning of "smallest discrete unit" and has caused confusion and duplicative compliance and reporting efforts for banking entities that also define trading desks for purposes unrelated to the Volcker Rule (*e.g.*, internal risk management and reporting and calculating regulatory capital requirements).[52]

The Agencies indicate that they are seeking comment on a potential multi-factor definition of "trading desk" that would be based on the same criteria typically used to establish trading desks for other operational, management and compliance purposes. In particular, the Agencies suggest an alternative definition of "trading desk" that is: (i) structured to establish efficient trading for a market sector; (ii) organized to ensure appropriate setting, monitoring and management review of the desk's trading and hedging limits, current and potential future loss exposures, strategies and compensation incentives; and (iii) characterized by a clearly-defined unit of personnel that typically: (a) engages in coordinated trading activity with a unified approach to its key elements; (b) operates subject to a common and calibrated set

of risk metrics, risk levels and joint trading limits; (c) submits compliance reports and other information as a unit for monitoring by management; and (d) books its trades together.[53]

II.A.3. Underwriting activities

The 2013 Rule includes an exemption for a banking entity's underwriting activities, which is statutorily designated as a permitted activity under the Volcker Rule,[54] subject to the following conditions (among others):[55]

(1) The trading desk's "underwriting position" must be related to a "distribution" of securities in which the banking entity is acting as an "underwriter."[56]

(2) The amount and type of the securities in the trading desk's underwriting position must be designed not to exceed the reasonably expected near-term demands of clients, customers or counterparties, and reasonable efforts must be made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity and depth of the market for the relevant type of security.

(3) The banking entity must establish, implement, maintain and enforce an internal compliance program that meets specified requirements with respect to underwriting activity.

(4) The compensation arrangements of persons performing the banking entity's underwriting activities must be designed not to reward or incentivize prohibited proprietary trading.

(5) The banking entity must be licensed or registered to engage in underwriting activity if and to the extent required by applicable law.

The Agencies retain a number of these conditions in the Proposed Rule, but also propose changes that are intended to "tailor, streamline, and clarify the requirements that a banking entity must satisfy to avail itself of the underwriting exemption."[57] In explaining these changes, the Agencies note that, since the adoption of the 2013 Rule, "public commenters have observed that the significant compliance requirements in the regulation may unnecessarily constrain underwriting without a corresponding reduction in the type of trading activities that the rule was designed to prohibit."[58]

Accordingly, the Agencies propose the following revisions to the underwriting activities exemption:

- ***Presumption of RENTD compliance.*** Under the Proposed Rule, a banking entity's purchase or sale of a financial instrument is presumed to meet the underwriting RENTD requirement if the banking entity has established and implements, maintains and enforces limits, based on the nature and amount of the trading desk's underwriting activities, on: (i) the amount, types and risk of its underwriting position; (ii) the level of exposures to relevant risk factors arising from its underwriting position; and (iii) the period of time a security may be held.[59]
  - The Agencies indicate that they believe this presumption would "allow for a clearer application of the[] exemption[], and would provide banking entities with more flexibility and

certainty in conducting permissible underwriting . . . activities."[60] The Agencies further indicate that they expect a banking entity to establish these limits "according to its own internal analyses and processes around conducting its underwriting activities," which should include an "ongoing and internal assessment" of RENTD.[61]

- These limits are subject to review and oversight by the appropriate Agency on an ongoing basis to determine whether the limits are consistent with the statutory standard.[62] Furthermore, a banking entity is required "promptly" to report to the appropriate Agency "(A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the [Agency]."[63] The Agencies indicate that they would expect to closely monitor and review any instances of a banking entity exceeding a risk limit as well as any temporary or permanent increase to a trading desk limit.[64]
- An Agency may rebut the presumption of compliance if it determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the trading desk's reasonably expected near-term demands of clients, customers or counterparties by providing written notice of such a determination to the banking entity.[65]

- ***Compliance program requirement limited to banking entities with significant trading assets and liabilities.*** The Proposed Rule would amend the compliance program requirement[66] for the exemption for permitted underwriting activities (which, under the 2013 Rule, applies to all banking entities relying on the exemption) by making that requirement applicable only to banking entities with significant trading assets and liabilities.[67]
  - The Agencies clarify that banking entities that do not have significant trading assets and liabilities are not relieved of the obligation to comply with the other requirements of the exemption for underwriting activities, but the elimination of the exemption's compliance program requirement for such banking entities is intended to provide these banking entities with "an appropriate amount of flexibility to tailor the means by which they seek to ensure compliance with the underlying requirements of the exemption for underwriting activities, and to allow them to structure their internal compliance measures in a way that takes into account the risk profile and underwriting activity of the particular trading desk."[68]

II.A.4. Market making-related activities

The 2013 Rule includes an exemption for a banking entity's market making-related activities, which is statutorily designated as a permitted activity under the Volcker Rule,[69] subject to the following conditions (among others):[70]

(1) The trading desk that establishes and manages the "financial exposure"[71] must routinely stand ready to purchase and sell one or more types of financial instruments related to its financial exposure and be willing and available to quote, purchase and sell or otherwise enter into long and short positions in, those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity and depth of the market for the relevant types of financial instruments.

(2) The amount, types and risks of the financial instruments in the trading desk's "market-maker inventory"[72] must be designed not to exceed, on an ongoing basis, the

reasonably expected near-term demands of "clients, customers or counterparties,"[73] based on (i) the liquidity, maturity and depth of the market for the relevant types of financial instruments and (ii) demonstrable analysis of historical customer demand, current inventory of financial instruments and market and other factors regarding the amount, types and risks of or associated with financial instruments in which the trading desk makes a market, including through block trades.

(3) The banking entity must establish, implement, maintain and enforce an internal compliance program meeting specified requirements with respect to market making-related activity.

(4) The compensation arrangements of persons performing the banking entity's market making-related activities must be designed not to reward or incentivize prohibited proprietary trading.

(5) The banking entity must be licensed or registered to engage in market making-related activity if and to the extent required by applicable law.

The Agencies retain a number of these conditions in the Proposed Rule, but also propose changes that are intended to "tailor, streamline, and clarify the requirements that a banking entity must satisfy to avail itself of the market making exemption."[74] In explaining these changes, the Agencies note that their original rulemaking in connection with the 2013 Rule sought to balance two goals: "to allow market making to take place, which is important to well-functioning and liquid markets as well as the economy, and simultaneously to prohibit proprietary trading unrelated to market making or other permitted activities."[75] The Agencies go on to acknowledge that, based on their experience with the 2013 Rule, they believe that "the significant compliance requirements and lack of clear bright lines in the regulation may unnecessarily constrain market making" and "some of the requirements are unnecessary to prevent the type of trading activities that the rule was designed to prohibit."[76]

Accordingly, the Agencies propose to revise the exemption for market making-related activities in a manner that parallels the proposed amendments to the underwriting exemption discussed in Part II.A.3 above. Specifically, the Proposed Rule establishes a presumption that a banking entity's purchase or sale of a financial instrument meets the RENTD requirement of the market making-related activities exemption if the banking entity has established and implements, maintains and enforces the applicable "internally set limits" for the trading desk on (i) the amount, types and risks of the trading desk's market-maker positions; (ii) the amount, types and risks of the products, instruments and exposures the trading desk may use for risk management purposes; (iii) the level of exposures to relevant risk factors arising from its financial exposure; and (iv) the period of time a financial instrument may be held,[77] subject to (A) a requirement to report breaches or increases of the limits to the relevant Agency,[78] (B) review and oversight by the relevant Agency[79] and (C) the possibility of a rebuttal of the presumption by the relevant Agency.[80] The Proposed Rule would also amend the compliance program requirement for the exemption for permitted market making-related activities (which, under the 2013 Rule, applies to all banking entities relying on the

exemption) by making that requirement applicable only to banking entities with significant trading assets and liabilities, similar to the amendment to the corresponding provision of the underwriting exemption.[81]

II.A.5. Risk-mitigating hedging activities

The Proposed Rule modifies the 2013 Rule's exemption for permitted risk-mitigating hedging activities by streamlining the requirements for a banking entity to rely upon this exemption in several respects.[82]

Under the 2013 Rule, the prohibition on proprietary trading does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts or other holdings, provided that the activity satisfies certain compliance requirements related to monitoring, analysis and documentation.[83]

The 2013 Rule requires potentially extensive documentation in connection with the exemption for permitted risk-mitigating hedging activities. Specifically, the 2013 Rule requires additional documentation for hedges that:

(1) are established at a different level of organization than the specific trading desk establishing the related hedge positions, contracts or other holdings;

(2) are effected by the specific trading desk establishing or directly responsible for the underlying positions, contracts or other holdings through a financial instrument, exposure, technique or strategy that is not specifically identified in its written policies and procedures as one that it may use for hedging; or

(3) are established to hedge aggregated positions across two or more trading desks.

This documentation must be established contemporaneously with the hedging transaction and must document the trading desk or other business unit that is establishing and responsible for the hedge, the risk-mitigating purpose of the transaction and the risks of the individual or aggregated positions, contracts or other holdings that the transaction is designed to reduce. The 2013 Rule also requires each banking entity to conduct an analysis (including correlation analysis) supporting its hedging strategy, and the effectiveness of hedges must be monitored and recalibrated as necessary on an ongoing basis.[84]

With respect to banking entities with moderate or limited trading assets and liabilities, the Proposed Rule removes all requirements under the 2013 Rule's exemption except the requirements that the hedging activity be designed to reduce or otherwise mitigate one or more specific, identifiable risks arising in connection with and related to one or more identified positions, contracts or other holdings, and that the hedging activity be recalibrated to maintain compliance with the rule.[85]

With respect to banking entities with significant trading assets and liabilities, the Proposed Rule maintains most of the exemption's current requirements. However, the Proposed Rule modifies certain aspects of the requirements under the 2013 Rule's exemption, as follows:

- ***"Demonstrably reduces" or otherwise "significantly mitigates."*** The Proposed Rule eliminates the current requirement that the hedging activity "demonstrably reduces" or otherwise "significantly mitigates" risk.[86] The Agencies note that the requirement is not directly required by the statutory language, which requires only that the hedge "be designed" to reduce or otherwise significantly mitigate specific risks.[87] The Agencies acknowledge that, in practice, the requirement to show that hedging activity demonstrably reduces or otherwise significantly mitigates a specific, identifiable risk that develops over time can be complex, could potentially reduce *bona fide* risk-mitigating hedging activity and has been difficult for banking entities to comply with, due in large part to uncertainties that are inherent to hedging practices. In particular, the Agencies note that unforeseeable changes in market conditions, event risk, sovereign risk and other factors that cannot be known in advance could reduce or eliminate the otherwise intended hedging benefits.[88]
- ***Reduce documentation requirements.*** The Proposed Rule reduces documentation requirements associated with risk-mitigating hedging transactions that are conducted by one desk to hedge positions at another desk with pre-approved types of instruments within pre-set hedging limits.[89] The limits must be appropriately tailored for: (i) the size, types and risks of the hedging activities commonly undertaken by the trading desk; (ii) the financial instruments purchased and sold by the trading desk for hedging activities; and (iii) the levels and duration of the risk exposures being hedged.[90] The Agencies note that this proposed change is intended to provide clarity as to the types and characteristics of the limits needed to comply with the proposal.[91]
- ***Correlation analysis.*** The Proposed Rule eliminates the correlation analysis requirement of the 2013 Rule's exemption.[92] The Preamble indicates that the correlation analysis requirement was intended to indicate whether a potential hedging position, strategy or technique would demonstrably reduce the risk it is designed to hedge, thus suggesting it was not meant for speculative purposes.[93] However, the Agencies indicate that the removal of the requirement alleviates the practical difficulties with the correlation analysis requirement and the added delays, costs and uncertainty associated with the requirement without significantly impacting the conditions that risk-mitigating hedging activities must meet in order to qualify for the exemption.[94]

II.A.6. Liquidity management exclusion and error trade exclusion

(i) *Liquidity management*

The 2013 Rule does not contain a broad carve-out for banking entities' asset-liability management activities, which are typically directed toward mitigating liquidity, interest rate, foreign exchange or other risks to the banking entity, including through management of the banking entity's cash and cash equivalents. These activities may involve short-term trading in a variety of instruments, including U.S. Treasury securities, interest rate swaps and foreign exchange swaps. Under the 2013 Rule, the exclusion for liquidity management activities covers only purchases or sales of "securities" by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan that meets several requirements.[95]

The Proposed Rule broadens the liquidity management exclusion to allow banking entities to use foreign exchange forwards and foreign exchange swaps[96] and physically settled cross-currency swaps[97] as part of their liquidity management activities.[98] In proposing the change, the Agencies acknowledge that banking entities use foreign exchange forwards, foreign exchange swaps and cross-currency swaps to manage their liquidity in the United States and in foreign jurisdictions (for example, in the case of foreign branches and subsidiaries of U.S. banking entities that use foreign exchange products to manage the currency risk arising from their required holdings of foreign currencies).[99]

As a result of the proposed change, the Proposed Rule allows banking entities to purchase and sell financial instruments generally as part of their liquidity management activities to the same extent they may purchase or sell securities under the current exclusion, subject to the same conditions that currently apply with respect to securities transactions.[100]

The Proposed Rule limits the inclusion of cross-currency swaps to only swaps for which all payments are made in the currencies being exchanged, as opposed to cash-settled swaps. The Agencies indicate that this limitation is intended to address the risk that these instruments may be used for unauthorized proprietary trading and is necessary because, although foreign exchange forwards and foreign exchange swaps, as defined in the Commodity Exchange Act, are by definition limited to an exchange of the designated currencies, no similarly limited definition of the term "cross-currency swap" is available. Therefore, the Agencies have limited the exclusion to cash-settled swaps to prevent evasionary uses of cross-currency swaps.[101]

(ii) *Error trade exclusion*

The Proposed Rule establishes a new exclusion for any purchase or sale of a financial instrument that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error, provided that the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.[102] The Agencies explain that this exclusion is justified by the fact that such a purchase or sale lacks the requisite short-term trading intent under the statute.[103] The Agencies note that the exclusion will depend on the facts and circumstances of the transactions and may not be available if, for example, a banking entity fails to make reasonable efforts to prevent errors from occurring (as indicated, for example, by the magnitude or frequency of errors, taking into account the size, activities and risk profile of the banking entity) or to identify and correct trading errors in a timely and appropriate manner.[104]

II.A.7. Trading activities conducted solely outside of the United States

The Volcker Rule provides a statutory exemption for "[p]roprietary trading conducted by a banking entity pursuant to paragraph (9) or (13) of [Section 4(c) of the BHC Act], 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 [U.S.] States."[105] In the 2013 Rule, the Agencies' implementation of this exemption, referred to as the "TOTUS" exemption, requires that:

> (1) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any U.S. State;
>
> (2) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any U.S. State;
>
> (3) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any U.S. State;
>
> (4) No financing for the banking entity's purchases or sales is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any U.S. State; and
>
> (5) The purchase or sale is not conducted with or through any U.S. entity, other than:
>
> (A) A purchase or sale with the foreign operations of a U.S. entity, if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation or execution of such purchase or sale;
>
> (B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or
>
> (C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.[106]

The Proposed Rule retains the first three requirements of the 2013 Rule, modifies the first requirement and removes the fourth and fifth requirements, as explained below:[107]

- ***U.S. personnel engaged in arranging, negotiating or executing.*** The first requirement is modified to refer generally to "relevant personnel" instead of "any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale."[108] The effect of this change is that the Proposed Rule requires only that the relevant personnel engaged in the decision to purchase or sell not be located in the United States—the requirement that personnel who arrange, negotiate or execute such purchase or sale may not be located in the United States is proposed to be removed. The Agencies indicate that the purpose of this modification is to make

clear that some limited involvement by U.S. personnel is consistent with this exemption, so long as the "principal risk and actions of the purchase or sale do not take place in the United States."[109]

- ***Financing by U.S. branch of affiliate and conduct of trade "with or through any U.S. entity."*** The Agencies state that the elimination of the fourth and fifth requirements is intended to address concerns that these requirements unduly limit banking entities' ability to make use of the TOTUS exemption and have resulted in an impact on foreign banking entities' operations outside of the United States, as foreign banking entities have found the exemption's requirements to be "overly difficult and costly for banking entities to monitor, track, and comply with in practice."[110] The Preamble notes that this change represents a recognition that the regulatory requirements are broader than necessary to achieve compliance with the requirements of the Volcker Rule.[111]

The Agencies request comment as to whether the proposed modifications to the TOTUS exemption would result in disadvantages for U.S. banking entities competing with foreign banking entities. The Agencies recognize a concern that the proposal could lead to competitive disadvantages, as foreign banking entities would be able to trade directly with U.S. counterparties without being subject to the limitations associated with the exemptions for market making-related activities or other exemptions, which U.S. banking entities would need to rely on with respect to their operations in the United States and abroad.[112] The Agencies note that the proposal generally seeks to balance concerns regarding competitive impact, market bifurcation, reduced efficiency and liquidity of markets, overly burdensome restrictions on foreign banking entities and harm to U.S. market participants.[113]

II.B. COVERED FUND ACTIVITIES AND INVESTMENTS

The Volcker Rule prohibits a banking entity from acquiring or retaining any equity, partnership or other ownership interest in, or sponsoring or engaging in certain other relationships with, a hedge fund or a private equity fund.[114] The 2013 Rule captures the statute's reference to hedge funds and private equity funds with a single, expansive definition of a "covered fund." Specifically, under the 2013 Rule, "covered fund" means:

- any issuer that would be an "investment company," as defined in the Investment Company Act of 1940 (the "1940 Act"), *but for* Section 3(c)(1) or 3(c)(7) of the 1940 Act;
- certain privately offered commodity pools; and
- solely with respect to U.S. banking entities, certain foreign investment vehicles offered and sold outside of the United States.[115]

Notwithstanding recommendations in the Treasury Report and comments received in response to the OCC RFI, which contemplated that there should be changes to the definition of "covered fund" to address concerns that the current definition is overbroad and negatively affects lending activity and capital formation, the Proposed Rule does not include proposals for specific changes to the definition of "covered

fund" or any exclusions from covered fund status. Instead, the Agencies request comment on these aspects of the Proposed Rule, as discussed in greater detail below.

II.B.1. "Banking entity" status of certain entities excluded from the definition of "covered fund"

(i) *Exclusion of certain U.S. registered investment companies and foreign public funds from "banking entity" status*

The Agencies note in the Preamble that, since the adoption of the 2013 Rule, they have received a number of requests for guidance regarding scenarios in which certain funds that are excluded from the definition of "covered fund," such as RICs, FPFs or foreign excluded funds, are treated as banking entities under the 2013 Rule, with the consequence that such funds are subject to restrictions on proprietary trading and covered fund investments that may impair their ability to carry out their business.[116] These situations may occur as a result of the sponsoring banking entity having "control" over such a fund, including through the banking entity's investment during a seeding period or by virtue of corporate governance structures.

The staffs of the Agencies have addressed these requests through interagency FAQs, but without codifying their guidance through rulemaking:

- In FAQ #14,[117] the Agencies addressed the "banking entity" status of FPFs sponsored by a banking entity, stating that they would not advise that the activities and investments of an FPF excluded from the definition of "covered fund" be attributed to the sponsoring banking entity for purposes of the Volcker Rule, so long as the banking entity (i) does not own, control or hold with the power to vote 25% or more of any class of voting shares of the FPF after the seeding period and (ii) provides investment advisory, commodity trading, advisory, administrative and other services to the fund in compliance with applicable limitations in the relevant foreign jurisdiction.
- In FAQ #16,[118] the Agencies addressed the treatment of RICs and FPFs during seeding periods, stating that they would neither advise the Agencies to treat a RIC or FPF as a banking entity solely on the basis of the level of ownership of the RIC or FPF by a banking entity during a seeding period of "for example, three years," nor expect that a banking entity would submit an application to the Federal Reserve to determine the length of the seeding period.

The Agencies state in the Preamble that "nothing in the proposal would modify the application of the staff FAQs discussed above, and the Agencies will not treat RICs or FPFs that meet the conditions included in the applicable staff FAQs as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs."[119]

Furthermore, the Agencies clarify in the Preamble that FAQ #16's reference to a three-year period is an "example" of the seeding period for RICs and FPFs, and that the Agencies do not intend to "set[] any

maximum prescribed period for a RIC or FPF seeding period" and "[r]ecogniz[e] that the length of a seeding period can vary" and "may take some time."[120]

(ii) *Extension of relief from "banking entity" treatment for certain foreign excluded funds*

On July 21, 2017, the federal banking agencies released a policy statement indicating that they would not propose to take action, during the one-year period ending July 21, 2018, against a foreign banking entity[121] based on attribution of the activities and investments of a "qualifying foreign excluded fund"[122] to the foreign banking entity, or against a qualifying foreign excluded fund as a banking entity, in each case, where the foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, the qualifying foreign excluded fund would meet the requirements of the SOTUS exemption as if the qualifying foreign excluded fund were a covered fund.[123]

The Preamble states that, in order to accommodate the pendency of the proposal, the Agencies will extend the one-year stay of enforcement action for an additional year (*i.e.*, until July 21, 2019).[124] Relatedly, the Agencies pose a number of questions to solicit comments related to the "banking entity" status of foreign excluded funds that could support longer-term relief.[125]

II.B.2. Permitted underwriting and market making-related activities

Under the 2013 Rule, a banking entity may generally engage in underwriting and market making-related activities involving covered fund ownership interests, subject to the conditions of the exemptions from the prohibition on proprietary trading for underwriting and market making-related activities, which are discussed in Parts II.A.3 and II.A.4 of this Memorandum. However, a banking entity's ability to rely upon these exemptions with respect to covered fund ownership interests is conditioned on certain quantitative limitations and on a deduction from regulatory capital. This has led to industry comments that the exemptions for underwriting and market making-related activities involving covered fund ownership interests pose monitoring and compliance challenges that go beyond what is required in order to rely upon the analogous exemptions under the proprietary trading provisions.

Specifically, under the 2013 Rule, if a banking entity acquires or retains any ownership interest in the covered fund in connection with underwriting or market making-related activities and the banking entity guarantees, assumes or otherwise insures the obligations or performance of the fund or of any other covered fund in which the first covered fund invests, then that ownership interest must be counted toward (i) the so-called "per-fund limitation" on a banking entity's permitted investment in any single covered fund (with respect to funds that the banking entity sponsors or advises (among other relationships));[126] (ii) the so-called "aggregate funds limitation" on a banking entity's total permitted investments in all covered funds;[127] and (iii) the deduction from Tier 1 capital for certain permitted investments in covered funds.[128]

The Proposed Rule modifies in two principal respects the 2013 Rule's treatment of covered fund ownership interests acquired or retained in connection with underwriting or market making-related activities:[129]

- ***Disregarded in calculating aggregate funds limitation and capital deduction.*** The Proposed Rule modifies the 2013 Rule by eliminating the requirement that a banking entity include the value of any ownership interests in a covered fund that the banking entity acquires or retains in accordance with the underwriting or market making-related activities exemption for purposes of calculating the aggregate funds limitation and Tier 1 capital deduction, unless the banking entity sponsors or advises the fund (among certain other relationships).[130] Under the Proposed Rule, banking entities would continue to be required to include in the per-fund limitation, aggregate funds limitation and capital deduction any ownership interests in a covered fund acquired or retained in connection with underwriting or market making-related activities if the banking entity sponsors or advises the fund (among certain other relationships).[131]
- ***Guarantee, assumption or insurance of obligations or performance.*** The Proposed Rule eliminates the requirement in the 2013 Rule to include the value of any ownership interests in a covered fund that the banking entity acquires or retains in accordance with the underwriting or market making-related activities exemption for purposes of calculating the per-funds limitation, the aggregate funds limitation and Tier 1 capital deduction solely on the basis that the banking entity guarantees, assumes or otherwise insures the obligations or performance of the covered fund or of any other covered fund in which the first covered fund invests.[132]

II.B.3. Covered fund activities conducted solely outside of the United States

The 2013 Rule's implementation of the so-called "SOTUS" exemption[133] requires, among other conditions, that (i) no ownership interest in the covered fund is "offered for sale or sold" to a "resident of the United States" (defined to mean a "U.S. person" as defined in the SEC's Regulation S) (the "Marketing Restriction")[134] and (ii) no financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any U.S. state (the "Financing Restriction").[135]

The Proposed Rule modifies these two conditions in the following manner, but otherwise leaves the SOTUS exemption unchanged from the 2013 Rule:[136]

- ***Codification of guidance on Marketing Restriction.*** The Proposed Rule codifies the Agencies' previously issued guidance (provided in FAQ #13) regarding the Marketing Restriction.[137] Specifically, the Proposed Rule provides that an ownership interest in a covered fund is not "offered for sale or sold to a resident of the United States" only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity *participates*.[138] If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed to *participate* in any offer or sale by the covered fund of ownership interests in the covered fund.[139]

- ***Elimination of Financing Restriction.*** The Proposed Rule eliminates the Financing Restriction from the SOTUS exemption for the same reasons described in Part II.A.7 with respect to the elimination of the analogous restriction from the TOTUS exemption.[140] The Agencies explain that this modification is intended to streamline the requirements of the SOTUS exemption, which are designed to require that the principal risks of covered fund investments and sponsorship by foreign banking entities occur and remain solely outside of the United States.[141]

II.B.4. Permitted risk-mitigating hedging activities

Under the 2013 Rule, the statutory exemption for risk-mitigating hedging activities[142] is available with respect to the prohibition on acquiring or retaining an ownership interest in a covered fund solely in the context of an acquisition or retention that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund.[143] The Proposed Rule retains this exemption[144] and adds an additional exemption as discussed immediately below.

The 2011 notice of proposed rulemaking issued prior to the adoption of the 2013 Rule indicated that the Agencies were considering permitting a banking entity to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.[145] However, in adopting the 2013 Rule, the Agencies removed this type of activity from the scope of the covered funds exemption for permitted risk-mitigating hedging activity based on their determination that such transactions constituted a high-risk strategy that could threaten the safety and soundness of the banking entity.[146]

The Proposed Rule would, in a reversal of the Agencies' commentary accompanying the 2013 Rule, permit a banking entity to acquire an ownership interest in a covered fund as a risk-mitigating hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.[147] In explaining this change, the Agencies acknowledge that, although a banking entity could be exposed to the risk of the covered fund if the customer fails to perform, "this counterparty default risk would be present whenever a banking entity facilitates the exposure by the customer to the profits and losses of a financial instrument and seeks to hedge its own exposure by investing in the financial instrument."[148]

A banking entity that seeks to use a covered fund ownership interest to hedge on behalf of a customer would need to comply with all the requirements of Section _.13(a) of the Proposed Rule, which generally track the requirements of the exemption for permitted risk-mitigating hedging activity from the proprietary trading restriction set forth in Section _.5 of the Proposed Rule (which are modified in certain respects from the 2013 Rule, as discussed in Part II.A.5 of this Memorandum).

II.B.5. Name sharing with organized and offered covered funds

Section 204 of the Reform Act amends the statutory restriction on the sharing of names between a banking entity and a covered fund that the banking entity permissibly organizes and offers. Specifically, the Reform Act permits funds to share the name or a variation of the same name of the banking entity that is an investment adviser to the fund so long as (i) the investment adviser is not, and does not share the name or a variation of the same name as, an insured depository institution, a company that controls an insured depository institution or a company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978 and (ii) the name does not contain the word "bank."

The NPR does not propose any changes to the 2013 Rule that would implement the Reform Act's amendments to the Volcker Rule, although it expressly states that the Agencies will not enforce the 2013 Rule in a manner inconsistent with these amendments. The Agencies indicate that they expect to address these amendments through a separate rulemaking process.[149]

II.C. COMPLIANCE PROGRAM AND QUANTITATIVE TRADING METRICS

The 2013 Rule establishes compliance program requirements for all banking entities (with simplified requirements for smaller banking entities), as well as reporting and metrics collection requirements for certain banking entities based on their size and the nature of their activities.[150]

The Agencies propose changes to the compliance program in the Proposed Rule with the stated goals of (i) reducing burdens and uncertainty for smaller institutions and instead focusing on compliance program requirements on banking entities with the most significant and complex trading activities;[151] (ii) providing flexibility to build on compliance regimes that already exist at banking entities, including risk limits, risk management systems, board-level governance protocols and the level at which compliance is monitored;[152] and (iii) simplifying overly prescriptive requirements, including certain elements of the 2013 Rule's "enhanced" compliance program.[153]

II.C.1. Compliance program requirement

The key aspects of the Proposed Rule's compliance program requirement are as follows:

- ***Categorization based on trading assets and liabilities.*** As explained in Part I of this Memorandum, the Proposed Rule establishes three categories of banking entities, each defined based on a specified threshold of trading assets and liabilities and each subject to a different set of compliance program and other requirements.
- ***Removal of "enhanced" tier of compliance program requirements.*** The Agencies indicate that they believe many of the compliance requirements of the 2013 Rule's "enhanced" compliance program, as set forth in Appendix B to the 2013 Rule, "could be implemented effectively if incorporated into a risk management framework already developed and designed to

fit a banking entity's organizational and reporting structure."[154] Accordingly, the Proposed Rule eliminates Appendix B in its entirety. The Agencies further note that the "six-pillar" compliance program requirement that applies to banking entities with significant trading assets and liabilities "is consistent with general standards of safety and soundness as well as diligent supervision, the implementation of which conforms with the traditional risk management processes of ensuring governance, controls, and records appropriately tailored to the risks and activities of each banking entity."[155]

As under the 2013 Rule, the Proposed Rule's required compliance program may be implemented on an enterprise-wide basis or at a business-unit level, as long as the program satisfies all requirements and can be effectively administered. In either case, the banking entity may use common policies and procedures to the extent that they are appropriate for more than one trading desk. If an enterprise-wide program is established, the program will be subject to supervisory review by the appropriate Agency of each banking entity within the organization, and the organization will be expected to provide each appropriate Agency with access to all records related to the enterprise-wide program pertaining to any banking entity supervised by the Agency.[156]

II.C.2. Quantitative metrics reporting and recordkeeping requirements

The Agencies indicate that, since the adoption of the 2013 Rule and as part of its implementation, the Agencies have reviewed the metrics submitted by banking entities and considered whether all the quantitative measurements are useful for all asset classes and markets, as well as for all the trading activities subject to the metrics requirement, or whether modifications are appropriate. In the Proposed Rule, the Agencies propose amendments to Appendix A of the 2013 Rule with the stated objectives of (i) streamlining the metrics reporting and recordkeeping requirements: (ii) reducing compliance-related inefficiencies relative to the 2013 Rule; and (iii) allowing the collection of data to permit the Agencies to better monitor compliance with the Volcker Rule.[157] As noted in Part A of the Overview, only banking entities with significant trading assets and liabilities are required to report quantitative trading metrics under the Proposed Rule.

Summarized below are certain key aspects of the Proposed Rule's changes to the 2013 Rule's quantitative metrics regime:

- ***Changes to calculation and applicability of certain metrics.*** The Proposed Rule removes the Inventory Turnover and Customer-Facing Trade Ratio metrics and replaces them with the Positions and Transaction Volumes metrics, respectively.[158] In addition, the proposal provides that the Inventory Aging metric (renamed as the "Securities Inventory Aging" metric) would only apply to securities (and not to derivatives, as is the case under the 2013 Rule).[159] Furthermore, the Positions, Transaction Volumes and Securities Inventory Aging metrics would be applicable only to trading desks that rely upon the exemptions for underwriting or market making-related activities.[160] Finally, the proposal modifies the description of Stressed VaR to align its calculation with that of Value-at-Risk and provides that Stressed VaR is not required to be reported for

trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument."[161]

- ***Trading desk information.*** The proposal would require banking entities to report, for each trading desk engaged in covered trading activity: (i) the trading desk name and trading desk identifier; (ii) the type of covered trading activity; (iii) the trading desk description; (iv) the types of financial instruments and other products; (v) the legal entities that the trading desk uses; (vi) the legal entity type identification; (vii) the trading day indicator; and (viii) the currency reported and currency conversion rate.[162]
- ***Quantitative metrics identifying information.*** The proposal would require banking entities to submit, collectively for all relevant trading desks: (i) a Risk and Position Limits Information Schedule; (ii) a Risk Factor Sensitivities Information Schedule; (iii) a Risk Factor Attribution Information Schedule; (iv) a Limit/Sensitivity Cross-Reference Schedule; and (v) a Risk Factor Sensitivity/Attribution Cross-Reference Schedule.[163]
- ***Narrative Statement.*** The Proposed Rule includes a new requirement of a Narrative Statement that must: (i) describe any changes in calculation methods used for quantitative measures and indicate when such changes occurred; (ii) be prepared and submitted periodically and when there are any changes in the banking entity's trading desk structure or strategies;[164] (iii) report any other information the banking entity views as relevant for assessing the information schedules or quantitative measures; (iv) explain the banking entity's inability to report a particular quantitative measurement; and (v) provide notice if a trading desk changes its approach to including or excluding products that are not financial instruments in its metrics.[165]

III. ADDITIONAL AREAS IDENTIFIED FOR COMMENT BY AGENCIES

In the Preamble, the Agencies pose 342 numbered questions for public comment, many of which consist of multiple sub-questions, relating to specific aspects of the Proposed Rule. The Agencies' questions highlight a number of issues that are not addressed through any specific amendment in the Proposed Rule, but which have been the subject of extensive public comment. In many cases, the Agencies' questions appear to be designed to inform the Agencies' consideration of further potential revisions to significant elements of the Proposed Rule. Accordingly, the ultimate scope and contour of many significant aspects of the Volcker Rule remain open questions and should be influenced by the comment process that will follow publication of the NPR.

The below table provides a high-level, non-comprehensive overview of certain topics that the Agencies identify for comment and a summary of selected questions they pose on each such topic.

Topic	Areas Identified for Comment and Questions Posed
Overall Framework and Categorization of Banking Entities	
Rulemaking framework and Agency coordination	• Means to improve the transparency of the Agencies' implementation of the Volcker Rule. • Steps that could be taken with respect to interagency coordination to make compliance with the Volcker Rule more efficient and to promote the safety and soundness of banking entities and U.S. financial stability.[166]

Economic impact and compliance costs	• Whether certain proposals would meaningfully reduce compliance costs. The specific proposals with respect to which the Agencies pose this question include:
	  ◦ establishing a presumption of compliance for banking entities with limited trading assets and liabilities;
	  ◦ changes to the "trading account" definition;
	  ◦ the use of internally set risk limits to meet the RENTD requirements of the underwriting and market making-related activities exemptions;
	  ◦ changes to streamline the conditions of the risk-mitigating hedging exemption and the TOTUS exemption; and
	  ◦ changes to the metrics reporting requirements and to the compliance program requirements.[167]

Topic	Areas Identified for Comment and Questions Posed
Banking entity categorization and tailoring	• Appropriateness of establishing different requirements for banking entities based on thresholds of trading assets and liabilities. • Appropriateness of the specific thresholds that are proposed to delineate between the three categories of banking entities and the requirements that would apply to each category. • Potential to further tailor application of the regulations by categorizing certain banking entities separately from their subsidiaries and affiliates (*e.g.*, an SEC-registered broker-dealer that operates separately and independently from an affiliate with significant trading assets and liabilities).[168]
Proprietary Trading Provisions	
Definition of "trading account"	• Appropriateness of replacing the short-term intent prong with the proposed accounting prong, "considering the fact that entities may have discretion over whether certain financial instruments are recorded at fair value."[169] • Appropriateness of the scope of financial instruments proposed to be included in the accounting prong. • Costs of compliance with the dealer prong of the "trading account" definition.[170]
Presumption of compliance with proprietary trading prohibition	• Appropriateness of the proposed desk-level profit and loss threshold for presumed compliance with the prohibition on proprietary trading. • Appropriateness of the process by which banking entities would notify the appropriate Agency of instances when the threshold is crossed. • Appropriateness of the process by which the Agencies may rebut the presumption of compliance.[171]

Implications for banking entities regulated by market regulators	• Potential differences in the Proposed Rule's implications for banking entities regulated by market regulators as compared to other banking entities, including with respect to:
	  • the proposal to replace the short-term intent prong with an accounting prong, including the presumption of compliance;
	  • notice and response procedures, including the requirement that banking entities relying on the presumption of compliance must notify the Agencies of instances when the absolute daily profit and loss threshold has been exceeded; and
	  • costs of compliance.[172]

Definition of "trading desk"	• Potential consequences of a change to the definition of "trading desk," including with respect to the ability of banking entities and the Agencies to detect impermissible proprietary trading.[173] • Whether it would be appropriate to adopt a potential multi-factor definition of "trading desk" that would be based on the same criteria typically used to establish trading desks for other operational, management and

Topic	Areas Identified for Comment and Questions Posed
	compliance purposes. This definition would be: • structured to establish efficient trading for a market sector; • organized to ensure appropriate setting, monitoring and management review of the desk's trading and hedging limits, current and potential future loss exposures, strategies and compensation incentives; and • characterized by a clearly-defined unit of personnel that typically: (a) engages in coordinated trading activity with a unified approach to its key elements; (b) operates subject to a common and calibrated set of risk metrics, risk levels and joint trading limits; (c) submits compliance reports and other information as a unit for monitoring by management; and (d) books its trades together.[174]
Reservation of authority	• Appropriateness of the reservation of authority to allow the appropriate Agency, rather than the Agencies jointly, to determine whether a particular activity is proprietary trading, and the process for the foregoing determination.[175]
Underwriting exemption – RENTD limits and presumption of compliance	• Effects of the proposed presumption of compliance for underwriting activity within internally set risk limits, including: • how it would impact capital formation and liquidity of particular markets; • whether further guidance on how to set internal risk limits is necessary; • whether it is appropriately tailored to the underwriting market; and • the process by which the Agencies may rebut the presumption.[176]
Underwriting exemption – Compliance program and other requirements	• Whether compliance requirements for the underwriting activities exemption should only apply to banking entities with significant trading assets and liabilities. • Whether such requirements should be streamlined for such entities.[177]
Market making-related activities exemption – RENTD limits and presumption of compliance	• Effects of the proposed presumption of compliance for market making-related activities within internally set risk limits, including: • how it would impact the liquidity of particular markets; • whether further guidance on how to set internal risk limits is necessary; • whether the proposal would present problems for a trading desk that makes a market in derivatives; and • the process by which the Agencies may rebut the presumption.[178]

Topic	Areas Identified for Comment and Questions Posed
Market making-related activities exemption – Compliance program and other requirements	• Whether compliance requirements for the market making-related activities exemption should only apply to banking entities with significant trading assets and liabilities. • Whether such requirements should be streamlined for such entities.[179]
Market making-related activities exemption – Loan-related swaps	• Circumstances in which loan-related swaps should be permissible under the market making-related activities exemption. • Whether such swaps should be excluded from the definition of "proprietary trading" or made a permissible activity. • Whether trading in other types of swaps should also be addressed.[180]
Market making-related activities exemption – Market making-related hedging	• Whether the Agencies should clarify the ability of banking entities to engage in market making-related hedging. • Whether current restrictions impede the ability of banking entities to effectively and efficiently engage in such hedging. • How effective the current regulations are at reducing risk.[181]

Permitted risk-mitigating hedging activities	• Whether to remove the requirement that a correlation analysis be done to determine whether hedging transactions significantly mitigate specific risks.
	• How the correlation analysis requirement affects a banking entity's decisions on whether to enter into different types of hedges and the timing of hedging activities.
	• Whether exemptions should be provided for hedging activity that is accounted for under accounting principles.
	• The Agencies also solicit comment on:
	  ◦ reductions in compliance requirements for risk-mitigating hedging activities by banking entities that do not have significant trading assets and liabilities; and
	  ◦ an exclusion from enhanced documentation requirements for trading desks that hedge risks of other desks.[182]

Liquidity management exclusion	• Whether the proposal to modify the liquidity management exclusion to include foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps sufficiently protects against the possibility of banking entities using the exclusion to conduct impermissible speculative trading.[183]

Error trades	• Whether the proposed exclusion to correct *bona fide* trade errors:
	  ◦ aligns with banking entities' existing policies and procedures;
	  ◦ is appropriately calibrated and sufficiently clear; and

Topic	Areas Identified for Comment and Questions Posed
	• does not conflict with the rules of any self-regulatory organization.[184]
TOTUS exemption	• Whether proposed modifications to the TOTUS exemption effectively focus the exemption on the location of the principal actions and risk of the transaction. • Whether these modifications ensure that principal risk remains solely outside the United States. • Whether the proposals raise competitive equity concerns for U.S. banking entities.[185]
Covered Fund Provisions	

Definition of "covered fund"	• In considering whether to further tailor the 2013 Rule's general approach to defining the term "covered fund" and the 2013 Rule's definition of "covered fund" (before applying exclusions), the Agencies solicit comment on:
	  • whether and how to incorporate definitions of "hedge fund" and "private equity fund" into the rule's definition of "covered fund";
	  • whether the current definition of "covered fund" is over- or under-inclusive;
	  • whether the definitions of "foreign covered fund" and "commodity pool" effectively address concerns about circumvention of the Volcker Rule;
	  • challenges arising from complying with covered fund restrictions;
	  • costs that would arise from a change in the definition of "covered fund"; and
	  • how proposed modifications to other provisions of the 2013 Rule (*e.g.*, the exemptions for underwriting, market making-related and risk-mitigating hedging activities) may interact with the "covered fund" definition.[186]

Alternative definitional approaches	• Whether an exclusion from the "covered fund" definition should be provided for funds that (i) do not engage in transactions to profit from short-term price movements and (ii) do not invest in illiquid assets. • Whether to revise the base definition of "covered fund" using a characteristics-based approach. • Whether funds that lack certain traits of a hedge fund or private equity fund should be excluded from the definition of "covered fund." The Agencies note the possibility of leveraging the definitions of "hedge fund" and "private equity fund" from the SEC's Form PF to determine relevant traits (see below).[187] • *Hedge fund.* Form PF defines "hedge fund" to mean any private fund (other than a securitized asset fund[188]): (i) with respect to

Topic	Areas Identified for Comment and Questions Posed
	which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (ii) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital) or (iii) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration).[189] • *Private equity fund.* Form PF defines "private equity fund" not by reference to specific characteristics or traits, but rather as any private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund, as those terms are defined in Form PF.[190] In this regard, the Agencies note also that they understand private equity funds commonly (i) have restricted or limited investor redemption rights; (ii) invest in public and non-public companies through privately negotiated transactions resulting in private ownership of the business; (iii) acquire the unregistered equity or equity-like securities of such companies that are illiquid as there is no public market and third-party valuations are not readily available; (iv) require holding investments long-term; (v) have a limited duration of ten years or less; and (vi) realize returns on investments and distribute the proceeds to investors before the anticipated expiration of the fund's duration.[191]

Exclusions for FPFs and RICs	• Whether the current FPF exclusion captures funds that are sufficiently similar to RICs and excludes those that are insufficiently similar.
	• Whether the current RIC exclusion is appropriate.
	• Whether concerns about the use of FPFs to evade the 2013 Rule justify conditions imposed on FPFs but not RICs, or whether the Agencies should address such concerns through, for instance, an anti-evasion provision.
	• The Agencies also solicit comment on all aspects of the FPF exclusion, including the conditions to the exclusion that:
	  • the fund must be "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction";
	  • ownership interests must be sold "predominantly" through "public offerings" outside of the United States; and
	  • ownership interests must be sold predominantly to persons other than the sponsoring banking entity and certain related persons.
	• Whether previously released FAQ #5, which allows an entity formed and operated pursuant to a written plan to become an FPF to receive the same treatment as an entity formed and operated pursuant to written plans to become a RIC or BDC, should be incorporated into the regulations.[192]

Topic	Areas Identified for Comment and Questions Posed

Family wealth management vehicles	• The Agencies solicit information on family wealth management vehicles, including:
	  • what exclusions from the definition of "investment company" in the Investment Company Act they rely on;
	  • whether they should be excluded from the definition of "covered fund" and how such an exclusion would be structured;
	  • whether such an exclusion would create opportunities for evasion of the Volcker Rule;
	  • what services banking entities provide family wealth management vehicles; and
	  • whether there are similar vehicles that pose similar issues.[193]

Joint ventures	• Whether the exclusion for joint ventures has allowed banking entities to continue sharing the risk and cost of financing banking activities through joint ventures. • Whether changes should be made to the exclusion to clarify the condition that joint ventures may not be used to raise money from investors primarily for the purpose of trading in securities. • Whether changes should be made to clarify that the joint venture exclusion is designed to allow banking entities to structure business ventures. • How the term "joint venture" should be defined.[194] • Whether to incorporate in the Proposed Rule some or all the views expressed by the staffs in FAQ #15,[195] which is widely considered to have limited significantly the utility of this exclusion.
Securitizations	• How exclusions from the "covered fund" definition for loan securitizations, qualifying asset-backed commercial paper conduits and qualifying covered bonds have worked in practice. • Whether there are any assets that are not "loans" that should be considered permissible assets under the exclusion (including whether the Agencies should consider permitting a loan securitization vehicle to hold 5% to 10% of assets that are considered debt securities rather than "loans"). • Whether the view expressed in FAQ #4 that servicing assets may be any type of asset, provided that any servicing asset that is a security must be a permitted security, should be incorporated into the regulations. • Whether changes should be made to the definition of "ownership interest" in the context of securitizations.[196]
Selected other issuers	• Whether exclusions should be extended for entities, such as small business investment companies, that are excluded from the "covered fund" definition but may not be able to satisfy the relevant exclusion as the entity is liquidated. • Whether municipal securities tender option bond vehicles should be

Topic	Areas Identified for Comment and Questions Posed
	excluded from the definition of "covered fund."[197]
Underwriting and market making for a covered fund	• What effects the proposed changes to these exemptions would have on capital-raising activities of issuers. • How to align the relevant restrictions of these exemptions with those for engaging in underwriting and market making-related activities for other financial instruments. • Whether the Agencies should remove the requirement that the banking entity include for purposes of the per-fund limitation, aggregate funds limitation and capital deduction the value of any ownership interests of the covered fund acquired or retained in accordance with the underwriting or market making-related activities exemptions. • Whether any other restrictions on underwriting or market making of ownership interests in covered funds should be included or removed.[198]

SOTUS exemption – Generally	• Whether the Proposed Rule's implementation of the SOTUS exemption is:
	  • effective;
	  • clear regarding when a transaction or activity will be considered to have occurred solely outside the United States; and
	  • consistent with limiting the extraterritorial reach of the Volcker Rule with respect to FBOs.
	• Whether the Financing Restriction should be retained.
	• Whether the proposed changes to the exemption create competitive advantages for foreign banking entities.
	• Whether the proposal regarding the Marketing Restriction is sufficiently clear.[199]

Limitations on relationships with certain covered funds (Super 23A) – Scope and exemptions	• Whether other transactions between banking entities and covered funds should be prohibited or limited. • Whether the exemptions under Section 23A of the Federal Reserve Act and Regulation W should be incorporated into the regulations.[200] • Whether to incorporate the quantitative limits in Section 23A of the Federal Reserve Act and Regulation W.[201]
Limitations on relationships with certain covered funds (Super 23A) – FCM activities	• Whether clearing services provided by a futures commission merchant ("FCM") to its customers are a relationship that would raise policy concerns. • Whether the no-action relief provided by the CFTC staff to an FCM on March 29, 2017 and the non-objection of the other Agencies to this relief provides sufficient certainty for market participants.[202]

Topic	Areas Identified for Comment and Questions Posed
Compliance Program; Violations	
Requirements for banking entities with significant trading assets and liabilities	• Whether the six-pillar compliance program requirements should apply only to banking entities with significant trading assets and liabilities and whether the scope of the six-pillar compliance program is appropriate.[203]
Requirements for banking entities with limited trading assets and liabilities	• Whether to specify notice and response procedures in connection with an Agency determination that the presumption of compliance for banking entities with limited trading assets and liabilities is rebutted.[204]
Tailoring of compliance programs generally	• Whether the proposal to tailor compliance programs based on the type, size, scope and complexity of a banking entity's activities and business structure would be effective in ensuring that banking entities with significant or moderate trading assets and liabilities comply with the proprietary trading and covered fund requirements and restrictions of the Volcker Rule. • To what extent compliance programs are implemented by registered investment advisers as opposed to other banking entity affiliates or subsidiaries.[205]

CEO attestation requirement	• The Agencies solicit comment on the CEO attestation requirement, including with respect to:
	  ◦ its cost;
	  ◦ whether such attestation is redundant in light of existing business practices;
	  ◦ whether the scope of the requirement under the proposed three-tier scheme for banking entities is appropriate; and
	  ◦ whether incorporating the CEO attestation requirement would ensure that a strong governance framework is implemented with respect to compliance with the Volcker Rule.[206]

Independent testing, training and recordkeeping requirements	• Whether the current independent testing, training and recordkeeping requirements would, if appropriately tailored to the size, scope and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant or moderate trading assets and liabilities comply with the Volcker Rule.[207]
Reporting and recordkeeping requirements	• Whether certain proposed definitions (*i.e.*, "applicability," "trading day" and "covered trading activity") are effective and clear and whether any other terms should be defined.[208]

Topic	Areas Identified for Comment and Questions Posed
Quantitative Metrics Reporting and Recordkeeping	
Overall assessment of metrics reporting requirement	• Whether the quantitative metrics regime is an appropriate approach to identifying potentially prohibited proprietary trading. • The costs of reporting quantitative measurements and proposed qualitative reporting requirements. • Whether a trading desk should be permitted not to furnish a quantitative measurement in certain circumstances, or be required to report activity conducted under different exemptions separately. • Whether quantitative measures should be made public in some form.[209]

Nature and scope of information reporting	• The Agencies solicit comment on the proposed Trading Desk Information and Quantitative Measurements Identifying Information and the proposed Narrative Statement requirement, including:
	  • whether such proposals are sufficiently clear;
	  • whether such information would be helpful in understanding a trading desk's covered trading activities and associated risks; and
	  • the costs of preparing such information.[210]

Frequency and method of required calculation and reporting	• Whether the proposed frequency of reporting the Trading Desk Information, Quantitative Measurements Identifying Information and the Narrative Statement is appropriate and effective (specifically, with respect to the proposal to adjust the reporting schedule for banking entities with $50 billion or more in trading assets and liabilities to within 20 days of the end of each calendar month). • Whether implementing the proposed Appendix's electronic reporting requirement and XML Schema, as well as certain record retention requirements, would be practical or appropriate.[211]
Stressed Value-at-Risk metric	• Whether Stressed Value-at-Risk limits should be removed as a reporting requirement for desks engaged in permitted market making-related activity or risk-mitigating hedging activity. • Whether banking entities should be required to report the limit size of both the upper and lower bound of a limit.[212]
Comprehensive Profit and Loss Attribution metric	• Whether to clarify that Residual Profit and Loss is only profit and loss that cannot be attributed to existing or new positions, and to add a separate reporting item for Unexplained Profit and Loss from Existing Position. • How best to specify the calculation for Profit and Loss due to Risk Factor Changes (including, for example, aligning the calculation with "hypothetical" or "Clean P&L" as prescribed by the market risk capital rules; or clarifying the definition to be the sum of all profit and loss attributions regardless of whether they are reported individually).[213]

Topic	Areas Identified for Comment and Questions Posed
Inventory Turnover metric	• Whether the Inventory Turnover metric should be removed or replaced. • Whether the proposed Positions metric would be effective in helping distinguish between permitted and prohibited trading activities (including with respect to the identification of high-risk strategies and the evaluation of underwriting and market making-related activities).[214]
Customer-Facing Trade Ratio metric	• Whether the Customer-Facing Trade Ratio metric should be removed or replaced. • Whether the proposed Transaction Volumes metric would be effective in helping to distinguish between permitted and prohibited trading activities (including with respect to the evaluation of underwriting and market making-related activities). • Whether detailed instructions are needed regarding how different transaction life cycle events such as amendments, novations, compressions, maturations, allocations, unwinds, terminations, option exercises, option expirations and partial amendments affect the calculation of Transaction Volumes and the Comprehensive Profit and Loss Attribution.[215]
Securities Inventory Aging metric	• Whether the proposed Securities Inventory Aging metric is effective in evaluating underwriting or market making-related activity. • Whether inventory aging of derivatives and/or futures is a useful metric for monitoring covered trading activity at trading desks.[216]

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ENDNOTES

[1] The Agencies are the Federal Reserve, the Office of the Comptroller of the Currency (the "OCC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC"). As of the time of publication of this Memorandum, the SEC has yet to take action to approve the NPR, but is scheduled to do so on the date hereof. The Governors of the Federal Reserve and the members of the Board of Directors of the FDIC voted unanimously to approve the NPR at their respective meetings, and Comptroller Joseph Otting stated during the meeting of the Board of Directors of the FDIC that he approved the NPR on behalf of the OCC. At the vote of the CFTC approving the NPR, Commissioner Rostin Behnam dissented from the other two Commissioners.

[2] It is expected that the version of the NPR approved by each Agency and related materials released to the public in connection with each Agency's approval of its version of the NPR will be posted by each Agency on its website. As of the time of publication of this Memorandum, materials released by the Federal Reserve are available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180530a.htm and those of the FDIC are available at https://www.fdic.gov/regulations/reform/volcker/rule.html.

[3] Preamble at 16 n.19 (citing statements by Randal K. Quarles, Vice Chair, Federal Reserve; Daniel K. Tarullo, Former Governor, Federal Reserve; and Martin J. Gruenberg, Former Chair, FDIC). Commentaries from various regulators and policymakers have highlighted concerns with the 2013 Rule's complexity and compliance burden. *See, e.g.*, Janet L. Yellen, Former Chair, Federal Reserve: "[I]mplementation of [the Volcker Rule] is frankly complex, and I'm certainly open to looking at ways to reduce regulatory burden in that area." FOMC Press Conference (June 14, 2017), *available at* https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20170614.pdf; Daniel K. Tarullo, Former Governor, Federal Reserve: "[S]everal years of experience have convinced me that there is merit in the contention of many firms that, as it has been drafted and implemented, the Volcker rule is too complicated." *Departing Thoughts* (Apr. 4, 2017), *available at* https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm; Keith A. Noreika, Former Acting Comptroller of the Currency: "I have sought the views of my colleagues at the other federal banking agencies about simplifying the regulatory framework implementing the Volcker Rule. In recent years, many of the nation's financial institutions have struggled to understand and comply with these regulations, devoting significant resources that could have been put to more productive uses. There is near unanimous agreement that this framework needs to be simplified and clarified." *Fostering Economic Growth: Regulator Perspective: Hearing Before the Senate Banking Committee* (June 22, 2017), *available at* https://www.banking.senate.gov/imo/media/doc/Noreika%20Testimony%206-22-17.pdf.

[4] U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions* (June 12, 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf. Pages 71–78 of the Treasury Report discuss the Volcker Rule. For an overview of the Treasury Report, please see our Client Memorandum, *Treasury Issues Comprehensive Report on Depository System Regulatory Reforms*, dated June 14, 2017, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Treasury_Issues_Comprehensive_Report_on_Depository_System_Regulatory_Reforms.pdf.

[5] OCC, *Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input*, 82 Fed. Reg. 36692 (Aug. 7, 2017). For a discussion of the OCC RFI, please see our Client Memorandum, *Volcker Rule: Comptroller of the Currency Releases Request for Information on the Volcker Rule's Implementation, Application and Administration*, dated August 3, 2017, *available at* https://www.sullcrom.com/volcker-rule-comptroller-of-the-currency-releases-request-for-information-on-the-volcker-rules-implementation-application-and-administration.

[6] The NPR indicates that the Agencies expect to conduct a separate rulemaking process to address the Reform Act's amendments that affect the Volcker Rule. Preamble at 12. The Reform Act's two-part test for exemption from the Volcker Rule is summarized in Part I of this Memorandum.

[7] Public comment letters responding to the OCC RFI, including 87 unique comment letters, are available at https://www.regulations.gov/docket?D=OCC-2017-0014. A summary of the comment letters is available at https://occ.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-notice-comment-summary.pdf.

[8] OCC, Federal Reserve, FDIC and SEC, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5535 (Jan. 31, 2014); CFTC, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5807 (Jan. 31, 2014). Each Agency adopted the 2013 Rule and codified it separately in its respective regulations. *See* 12 C.F.R. §§ 248 (Federal Reserve); 44 (OCC); 351 (FDIC); and 17

C.F.R. §§ 255 (SEC); 75 (CFTC). References and citations herein to the 2013 Rule are to the common rule text.

9 For a discussion of the requirements of the 2013 Rule, please see our Client Memorandum, *Volcker Rule: U.S. Agencies Approve Final Volcker Rule, Detailing Prohibitions and Compliance Regimes Applicable to Banking Entities Worldwide*, dated January 27, 2014, *available at* https://www.sullcrom.com/Volcker-Rule-01-27-2014.

10 The Agencies issued on January 10, 2014 an "interim final rule" to provide relief with respect to banking entities' legacy interests in so-called "TruPS-backed CDOs." This interim final rule does not technically amend the 2013 Rule, but rather operates as a "companion rule" to the 2013 Rule. For further discussion of this interim final rule, please see our Client Memorandum, *Volcker Rule: Agencies Issue Interim Final Rule Exempting Certain TruPS-Backed CDOs from the Volcker Rule's Prohibition on Banking Entities' Holding Ownership Interests in or Sponsoring Covered Funds*, dated January 14, 2014, *available at* https://www.sullcrom.com/Volcker-Rule.

11 The staff of each Agency has released its respective version of each FAQ in substantively identical form. The FAQs issued to date by the staff of each Agency apply to banking entities over which that Agency has jurisdiction under the Volcker Rule. The FAQs, as prepared by the staff of each Agency and updated from time to time, can be accessed at the public website of each Agency: Federal Reserve (http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.html); FDIC (https://www.fdic.gov/regulations/reform/volcker/faq.html); OCC (https://occ.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-rule-implementation-faqs.html); SEC (https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm); CFTC (https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_28_VolckerRule/index.htm).

12 Of particular note are the federal banking agencies' policy statement regarding the treatment of foreign excluded funds (as discussed in our Client Memorandum, *Volcker Rule: Federal Banking Agencies Release New Guidance on the Treatment of "Foreign Excluded Funds" Under the Volcker Rule*, dated July 22, 2017, *available at* https://www.sullcrom.com/volcker-rule-federal-banking-agencies-release-new-guidance-on-the-treatment-of-foreign-excluded-funds-under-the-volcker-rule) and the Agencies' guidance regarding the capital treatment of certain ownership interests in covered funds (as discussed in our Client Memorandum, *Volcker Rule and Bank Capital: Agencies Release Guidance on Capital Treatment of Banking Entity Investments in TruPS CDOs*, dated March 4, 2016, *available at* https://www.sullcrom.com/volcker-rule-and-bank-capital-agencies-release-guidance-on-capital-treatment-of-banking-entity-investments-in-trups-cdos).

13 OCC RFI at 36693. *See also supra* note 3.

14 Preamble at 17.

15 Preamble at 17–18.

16 *See infra* note 25 (discussing the 2013 Rule's five tiers of compliance program requirements).

17 *See* text accompanying *infra* note 30 (noting that the Proposed Rule includes a reservation of authority that would allow an Agency to require a banking entity with limited or moderate trading assets and liabilities to apply any of the more extensive requirements that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities under certain circumstances).

18 For a discussion of the Reform Act, please see our Client Memorandum, *Financial Services Regulatory Reform Legislation: "Economic Growth, Regulatory Relief, and Consumer Protection*

Act" is Enacted, dated May 24, 2018, *available at* https://www.sullcrom.com/financial-services-regulatory-reform-legislation-economic-growth-regulatory-relief-and-consumer-protection-act-is-enacted. See Part II.B.5 of this Memorandum for a discussion regarding the amendment to the name sharing restriction.

19 Preamble at 12.

20 Treasury Report at 77.

21 *See supra* note 7.

22 OCC RFI at 36694 n.16.

23 In her statement in connection with the Federal Reserve's approval of the NPR, Governor Lael Brainard observed that the "requirement of CEO attestation is critical" to the revision of the RENTD framework. Lael Brainard, Governor, Federal Reserve, *Statement on the Volcker Rule Proposal*, May 30, 2018, *available at* https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20180530.htm. The Preamble underscores this point with respect to the compliance program-related proposals more broadly, noting that the Proposed Rule's simplification of the compliance program requirements "should be balanced against the requirement for all banking entities to maintain compliance with [the Volcker Rule] and the implementing regulations. Accordingly, the Agencies believe that applying the CEO attestation requirement for banking entities with meaningful trading activities would ensure that the compliance programs . . . are reasonably designed to achieve compliance with [the Volcker Rule] and the implementing regulations as proposed." Preamble at 218.

24 *See infra* note 30 (discussing the Agencies' "reserved authority").

25 The 2013 Rule's five tiers of compliance program requirements are as follows. For further detail regarding the specific requirements associated with each of these tiers, please see Section 10 of our Client Memorandum, *Volcker Rule: U.S. Agencies Approve Final Volcker Rule, Detailing Prohibitions and Compliance Regimes Applicable to Banking Entities Worldwide*, dated January 27, 2014, *available at* https://www.sullcrom.com/Volcker-Rule-01-27-2014/.

(1) Banking entities that engage in no restricted activities (*i.e.*, proprietary trading (other than permitted trading in U.S. government obligations) or covered fund-related activities or investments) are not subject to a compliance program requirement.

(2) Smaller banking entities with total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engage in restricted activities are subject to a reduced compliance burden, which requires only that such banking entities include in their existing compliance policies and procedures appropriate references to the requirements of the Volcker Rule.

(3) Banking entities that engage in restricted activities and do not fall into any of the other four tiers are required to implement and maintain a compliance program that meets several baseline requirements, commonly referred to as the "standard" compliance program.

(4) Larger banking entities and banking entities with significant trading activities are subject to "enhanced" compliance program requirements, which adds to the standard program additional and more detailed policies and procedures, internal controls, independent testing and other requirements, as well as an annual CEO certification requirement. This tier applies to banking entities with (A) total consolidated assets of $50 billion or more as of the previous calendar year-end, as calculated on the basis of

(i) all affiliates and subsidiaries globally, in the case of U.S. banking entities, and (ii) consolidated U.S. operations only, in the case of foreign banking entities; and/or (B) total "trading assets and liabilities," together with affiliates and subsidiaries, but excluding trading assets and liabilities involving U.S. government obligations, the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds $10 billion, as calculated with respect to U.S. banking entities and foreign banking entities in the manner described in the foregoing clauses (A)(i) and (ii).

(5) Banking entities with significant trading activities are subject to the "enhanced" compliance program requirements as well as a requirement to calculate and report quantitative trading metrics.

[26] Proposed Rule §§ ._2(ff)(2)–(3). *See also* Preamble at 21–22. Pages 5–6 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[27] Preamble at 12.

[28] The additional documentation requirements for covered funds under § _.20(e) of the 2013 Rule, which apply unchanged to banking entities with significant trading assets and liabilities under the Proposed Rule, include:

(1) documentation of the exclusions or exemptions other than Section 3(c)(1) or 3(c)(7) of the 1940 Act relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that the fund is not a covered fund;

(2) for each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of "covered fund" for foreign public funds, foreign pension or retirement funds, loan securitizations, qualifying asset-based commercial paper conduits or qualifying covered bonds, documentation supporting the banking entity's determination that the fund is not a covered fund;

(3) for each seeding vehicle that will become a RIC or an SEC-regulated BDC, a written plan documenting: the banking entity's determination that the seeding vehicle will become such a RIC or BDC, the period of time during which the vehicle will operate as a seeding vehicle and the banking entity's plan to market the vehicle to third-party investors and convert it into a RIC or BDC within the time period required under the 2013 Rule; and

(4) for any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any U.S. state, if the aggregate amount of ownership interests in foreign public funds owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or of any U.S. state) exceeds $50 million at the end of two or more consecutive calendar quarters, beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar

quarter, which documentation must continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters.

Proposed Rule § _.20(e). *See also* Preamble at 220–21. Pages 49–50 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

29 Preamble at 34–35.

30 The Proposed Rule also includes a reservation of authority that would allow an Agency to require a banking entity with limited or moderate trading assets and liabilities to apply any of the more extensive requirements that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities. Proposed Rule at § ._20(h). *See also* Preamble at 22–23. Page 51 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

31 *See supra* note 30.

32 Banking entities with limited trading assets and liabilities have no affirmative obligation to demonstrate compliance with the Proposed Rule on an ongoing basis. However, if upon examination or audit, the relevant Agency determines that the banking entity has engaged in covered activities, such Agency may rebut the presumption of compliance and require the banking entity to demonstrate compliance with the requirements of the rule applicable to a banking entity with moderate trading assets and liabilities. Proposed Rule § _.20(g). *See also* Preamble at 222.

33 The "short-term intent prong" includes within the definition of trading account any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of: (i) short-term resale; (ii) benefitting from short-term price movements; (iii) realizing short-term arbitrage profits; or (iv) hedging any of the foregoing. 2013 Rule § _.3(b)(1)(i).

34 2013 Rule § _.3(b)(1)(ii).

35 2013 Rule § _.3(b)(1)(iii).

36 The Preamble explained the removal of the short-term intent prong is meant to address concerns that the prong requires banking entities and the Agencies to make subjective determinations with respect to each trade a banking entity conducts, and that the 60-day rebuttable presumption may scope in activities that do not involve the types of risks or transactions the statutory definition of proprietary trading appears to have been intended to cover. Preamble at 58–59.

37 Proposed Rule § _.3(b). *See also* Preamble at 24–25. Pages 6–8 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

38 Proposed Rule § _.3(b)(1)(i). *See also* Preamble at 59. Pages 6–7 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

39 Proposed Rule § _.3(b)(1)(ii). *See also* Preamble at 59. Pages 6–7 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

40 Proposed Rule § _3(b)(2). *See also* Preamble at 59. Page 7 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule. The Agencies note that they are proposing to retain the "market risk capital prong" and the

"dealer prong" because "both prongs provide clear lines and well-understood standards for purposes of determining whether or not a purchase or sale of a financial instrument is in the trading account." Preamble at 60.

41 Proposed Rule § _.3(b)(3). *See also* Preamble at 61. Pages 7–8 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule. For this purpose, "applicable accounting standards" means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the relevant Agency determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements. Proposed Rule § _.2(b). *See also* Preamble at 26 n.34. Page 2 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

42 As discussed further in Part II.A.2 of this Memorandum, the Proposed Rule does not change the definition of "trading desk" from the 2013 Rule. However, the Agencies' solicitation of comments regarding alternatives to the current definition suggests that the Agencies are considering revisions to this definition.

43 Proposed Rule § _.3(c). *See also* Preamble at 68. Pages 7–8 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

44 Preamble at 26. The Agencies clarify that, "if the positions of a trading desk have recently significantly contributed to the financial position of the banking entity, such that the absolute P&L-based threshold is exceeded, the proposed trading-desk-level presumption would become unavailable and the banking entity would be required to comply with more extensive requirements of the rule to ensure compliance." Preamble at 68. A banking entity may choose to demonstrate ongoing compliance for activity captured by the accounting prong rather than calculating the profit and loss measurement for presumed compliance described above and relying on the presumption of compliance. Preamble at 67.

45 Preamble at 70 n.71.

46 Proposed Rule § _.3(c)(3)(i). *See also* Preamble at 71. Page 8 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

47 Proposed Rule § _.3(g)(1). *See also* Preamble at 71–72. Page 12 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

48 Preamble at 67.

49 Preamble at 61–62.

50 Preamble at 81. *See also* 2013 Rule §§ _.4(a)(2);_.4(b)(2).

51 2013 Rule § _.3(e)(13).

52 Preamble at 82.

53 Preamble at 82–83.

54 BHC Act §13(d)(1)(B) (12 U.S.C. § 1841(d)(1)(B)).

55 2013 Rule § _.4(a).

56 For purposes of the 2013 Rule, an "underwriting position" is the set of long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which the banking

entity or an affiliate is acting as an underwriter. 2013 Rule § _.4(a)(6). A "distribution" includes an offering of securities: (i) whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the presence of special selling efforts and methods; or (ii) made pursuant to an effective registration statement under the Securities Act. 2013 Rule § _.4(a)(3). An "underwriter" is either: (i) a person who *has an agreement* with an issuer or selling security holder to purchase securities for distribution or to otherwise engage in or manage a distribution for or on behalf of the issuer or selling security holder; or (ii) a person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder. 2013 Rule § _.4(a)(4).

[57] Preamble at 90.

[58] Preamble at 90.

[59] Proposed Rule §§ _.4(a)(8)(i)(A); _.4(a)(8)(i)(B)(1)–(3). *See also* Preamble at 93. Pages 14–15 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[60] Preamble at 27.

[61] Preamble at 93–94.

[62] Proposed Rule § _.4(a)(8)(ii). *See also* Preamble at 94. Page 15 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[63] Proposed Rule § _.4(a)(8)(iii). *See also* Preamble at 94. Page 15 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[64] Preamble at 95.

[65] Proposed Rule § _.4(a)(8)(iv). *See also* Preamble at 95. Page 15 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[66] 2013 Rule § _.4(a)(2)(iii).

[67] Proposed Rule § _.4(a)(2)(iii). *See also* Preamble at 100. Page 13 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[68] Preamble at 101.

[69] BHC Act §13(d)(1)(B).

[70] 2013 Rule § _.4(b).

[71] The 2013 Rule defines "financial exposure" to mean the aggregate risks of one or more financial instruments and any associated loans, commodities or foreign exchange or currency held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities. 2013 Rule § _.4(b)(4).

[72] The 2013 Rule defines "market-maker inventory" to mean all the positions in the financial instruments for which the trading desk stands ready to make a market that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions. 2013 Rule § _.4(b)(5).

[73] The 2013 Rule defines "clients, customers and counterparties" for purposes of the market making-related activities exemption to mean "market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services." 2013 Rule § _.4(b)(3). A trading desk or other organizational unit of a second entity is not a "client, customer or counterparty" of a trading desk of the first entity, however, if the second entity has $50 billion or more in total trading assets and liabilities (as measured for purposes of the 2013 Rule's quantitative trading metrics reporting requirements), unless: (i) the first trading desk documents how and why the second trading desk should be treated as a "client, customer, or counterparty" of the trading desk or (ii) the purchase or sale is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants. 2013 Rule § _.4(b)(3)(i). The Proposed Rule does not change this definition other than by noting that the $50 billion trading assets and liabilities threshold referred to above should be calculated based on the same methodology that is used to determine whether a banking entity has "significant trading assets and liabilities."

[74] Preamble at 105.

[75] Preamble at 104.

[76] Preamble at 104–05.

[77] Proposed Rule § _.4(b)(6)(i)(B). *See also* Preamble at 108. Page 17 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule. As with the presumption of compliance with the underwriting exemption's RENTD requirement, the Agencies indicate that they expect a banking entity to establish the requisite limits "according to its own internal analyses and processes around conducting its market making activities," which should include an "ongoing and internal assessment" of RENTD. Preamble at 109–10.

[78] Proposed Rule § _.4(b)(6)(iii). *See also* Preamble at 109. Page 17 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule. The Agencies indicate that they would expect to closely monitor and review any instances of a banking entity exceeding a risk limit as well as any temporary or permanent increase to a trading desk limit. Preamble at 110.

[79] Proposed Rule § _.4(b)(6)(ii). *See also* Preamble at 110. Page 17 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[80] Proposed Rule § _.4(b)(6)(iv). *See also* Preamble at 110. Page 17–18 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

[81] 2013 Rule § _.4(b)(2)(iii); Proposed Rule § _.4(b)(2)(iii). *See also* Preamble at 116. Page 15 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule. As is the case with respect to the underwriting exemption, the Agencies clarify that banking entities that do not have significant trading assets and liabilities are not relieved of the obligation to comply with the other requirements of the exemption for market making-related activities, but the elimination of the compliance program requirement for such banking entities is intended to provide these banking entities with "an appropriate amount of flexibility to tailor the means by which they seek to ensure compliance with the underlying requirements of the exemption for market making-related activities, and to allow them to structure their internal compliance measures in a way that takes into account the risk profile and market making activity of the particular trading desk." Preamble at 117.

ENDNOTES (CONTINUED)

82 Proposed Rule § _.5. *See also* Preamble at 27. Pages 18–20 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

83 2013 Rule § _.5.

84 2013 Rule § _.5(b)(1)–(2).

85 Proposed Rule § _.5(b). *See also* Preamble at 307.

86 Proposed Rule §§ _.5(b)(1)(i)(C); _.5(b)(1)(ii)(B); _.5(b)(1)(ii)(D)(2). *See also* Preamble at 130–31. Pages 18–19 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

87 Preamble at 130.

88 Preamble at 130.

89 Proposed Rule § _.5(c)(4). *See also* Preamble at 134–35. Page 20 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

90 Proposed Rule § _.5(c)(4)(ii). *See also* Preamble at 134–35. Page 20 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

91 Preamble at 135.

92 Proposed Rule § _.5(b)(1)(i)(C). *See also* Preamble at 129. Page 18 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

93 Preamble at 128.

94 Preamble at 128–29.

95 2013 Rule § _.3(d)(3).

96 The Proposed Rule's definitions of "foreign exchange forward" and "foreign exchange swap" reference the corresponding definitions of such terms in the Commodity Exchange Act. Proposed Rule § _.3(d)(3). *See also* 7 U.S.C. §§ 1a(24) and 1a(25).

97 The Proposed Rule defines a "cross-currency swap" as a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into. The Preamble states that this definition is consistent with regulations pertaining to margin and capital requirements for covered swap entities, swap dealers, and major swap participants. Proposed Rule § _.3(f). *See also* Preamble at 77 n.78 (citing 12 CFR § 45.2; 12 CFR § 237.2; 12 CFR § 349.2; 17 § CFR 23.151).

98 Proposed Rule § _.3(e)(3). *See also* Preamble at 76. Pages 8–9 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

99 Preamble at 76.

100 *See* Proposed Rule §§ _.3(e)(3)(i)–(vi). *See also* Preamble at 77. Pages 8–9 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

ENDNOTES (CONTINUED)

101 Preamble at 77–78.

102 Proposed Rule § _.3(e)(10). *See also* Preamble at 79. Page 10 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

103 Preamble at 27.

104 Preamble at 80.

105 BHC Act § 13(d)(1)(H).

106 2013 Rule § _.6(e)(3).

107 Proposed Rule § _.6(e)(3). *See also* Preamble at 140. Pages 23–24 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

108 Proposed Rule § _.6(e)(3). *See also* Preamble at 140. Pages 23–24 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

109 Preamble at 141.

110 Preamble at 142–43.

111 Preamble at 142.

112 Preamble at 146.

113 Preamble at 146.

114 BHC Act § 13(a)(1).

115 2013 Rule § _.10(b).

116 Preamble at 43–45.

117 For a discussion of the response to FAQ #14, please see our Client Memorandum, *Agencies Release New Guidance Providing Clarification Regarding Banking Entity Status of Certain Foreign Public Funds and Restricting Scope of Joint Venture Exclusion*, dated June 12, 2015, *available at* https://www.sullcrom.com/volcker-rule-agencies-release-new-guidance-providing-clarification-regarding-banking-entity-status.

118 FAQ #16 is available on the Federal Reserve's website at https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm.

119 Preamble at 49.

120 Preamble at 46.

121 For purposes of the policy statement, "foreign banking entity" means a banking entity that is not, and is not controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or any U.S. State. *See also infra* note 123.

122 For purposes of the policy statement (*see infra* note 123), a "qualifying foreign excluded fund" means, with respect to a foreign banking entity, an entity that:

(1) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(2) Would be a covered fund were the entity organized or established in the United States, or is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in financial instruments for resale or other disposition or otherwise trading in financial instruments;

(3) Would not otherwise be a banking entity except by virtue of the foreign banking entity's acquisition or retention of an ownership interest in, or sponsorship of, the entity;

(4) Is established and operated as part of a *bona fide* asset management business; and

(5) Is not operated in a manner that enables the foreign banking entity to evade the requirements of the Volcker Rule or implementing regulations.

123 For a discussion of the policy statement, please see our Client Memorandum, *Federal Banking Agencies Release New Guidance on the Treatment of "Foreign Excluded Funds" Under the Volcker Rule*, dated July 22, 2017, *available at* https://www.sullcrom.com/volcker-rule-federal-banking-agencies-release-new-guidance-on-the-treatment-of-foreign-excluded-funds-under-the-volcker-rule.

124 Preamble at 49.

125 Preamble at 52–54 (Questions #18–21).

126 2013 Rule §§ _.11(c)(2); _.12(a)(2)(ii). The "per-fund limitation" provides that the banking entity's (and its affiliates') permitted ownership interest in a single covered fund that it organizes and offers generally may not exceed 3% of the total outstanding "ownership interests" of the covered fund at any time one year or later after the "date of establishment" of the fund. Such other relationships (in addition to sponsoring or serving as investment adviser or commodity trading advisor to the fund) are that the banking entity otherwise acquires and retains an ownership interest in such covered fund in reliance upon the organizing and offering exemptions under Section _.11(a) or (b) of the 2013 Rule and the Proposed Rule. 2013 Rule § _.11(c)(2). The Supplementary Information to the 2013 Rule (the "2013 Rule Preamble") notes that a right to put the ownership interest in the covered fund to the banking entity would be considered a guarantee for this purpose; however, the restriction does not apply to arrangements not designed to guarantee the obligations or performance of the covered fund, however, such as entering into a liquidity facility or providing a letter of credit for a covered fund. 2013 Rule Preamble at 5723.

127 2013 Rule §§ _.11(c)(2); _.12(a)(2)(iii). The "aggregate funds limitation" provides that the aggregate value of the banking entity's ownership interests in covered funds held under the organizing and offering and underwriting and market making-related activities exemptions may not exceed 3% of the banking entity's Tier 1 capital, derived according to a specific calculation.

128 2013 Rule §§ _.11(c)(2); _.12(d). Under the 2013 Rule, all covered fund ownership interests held under the organizing and offering and underwriting and market making-related activities exemptions must be deducted on a dollar-for-dollar basis from the banking entity's actual Tier 1 capital for regulatory capital purposes.

129 Proposed Rule § _.11(c). *See also* Preamble at 194–95. Page 36 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

130 Proposed Rule § _.11(c). Page 36–37 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

131 Proposed Rule § _.11(c)(2). *See supra* note 126 (discussing such other relationships). *See also* Preamble at 194.

132 Proposed Rule § _.11(c)(2). Page 36 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

133 The Volcker Rule includes a statutory exemption for "[t]he 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 4(c) of the BHC Act] 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 [U.S.] States." BHC Act § 13(d)(1)(I). The 2013 Rule Preamble explains that "the purpose of this statutory exemption appears to be to limit the extraterritorial application of the statutory restrictions on covered fund activities and investments, while preserving national treatment and competitive equality among U.S. and foreign banking entities within the United States." 2013 Rule Preamble at 5738.

134 2013 Rule §§ _.13(b)(1)(iii); _.10(d)(8).

135 2013 Rule §§ _.13(b)(1)(iv); _.13(b)(4)(iv).

136 Proposed Rule § _.13(b). *See also* Preamble at 204–08. Pages 42–44 of Appendix A of this Memorandum contain the changes made to this provision as between the 2013 Rule and the Proposed Rule.

137 Following the issuance of the 2013 Rule, the Marketing Restriction became the subject of uncertainty and industry comment, as it was unclear whether foreign banking entities would be able to rely on the SOTUS exemption with respect to investments in third-party covered funds, such as offshore feeder funds with U.S. tax-exempt investors or other covered funds, where the fund sponsor or investors other than the foreign banking entity had engaged in U.S. marketing activities. The staffs of the Agencies issued guidance through a response to FAQ #13 clarifying that the Marketing Restriction applies *only* to the activities of the foreign banking entity (including its affiliates) that is seeking to rely on the SOTUS exemption and not to the activities of third parties, including the sponsor of the covered fund, other investors and the covered fund itself. Thus, a foreign banking entity's ability to rely on the exemption would not be lost as a result of third parties' marketing or selling activities to residents of the United States, provided that the foreign banking entity has not itself offered for sale or sold an ownership interest in the fund to a resident of the United States or participated in such an offer or sale. Client Memorandum, *Agencies Release New Volcker Rule FAQ with Critical Guidance for Foreign Banking Entities and Fund Sponsors; Clarify That U.S. Marketing Restriction Under "SOTUS" Covered Fund Exemption Does Not Apply to Third* Parties, dated February 27 2015, *available at* https://www.sullcrom.com/volcker-rule-agencies-release-new-volcker-rule-faq-with-critical-guidance-for-foreign-banking-entities-and-fund-sponsors.

138 Proposed Rule § _.13(b)(3). *See also* Preamble at 205–07. Page 43 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

139 Proposed Rule § _.13(b)(3). *See also* Preamble at 205–07. Page 43 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

140 Proposed Rule § _.13(b)(4). *See also* Preamble at 203. Page 44 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

141 Preamble at 203.

142 BHC Act § 13(d)(1)(C).

143 *See* 2013 Rule § _.13(a)(1).

144 Proposed Rule § _. 13(a)(1). *See also* Preamble at 199. Page 42 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

145 *See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 76 Fed. Reg. 68846 (Nov. 7, 2011).

146 2013 Rule Preamble at 5737. As the Agencies explain in the Preamble, "[t]he Agencies were concerned that these transactions could expose the banking entity to the risk that the customer will fail to perform, thereby effectively exposing the banking entity to the risks of the covered fund, and that a customer's failure to perform may be concurrent with a decline in value of the covered fund, which could expose the banking entity to additional losses." Preamble at 198.

147 Proposed Rule § _.13(a)(1)(ii). *See also* Preamble at 199. Page 42 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

148 Preamble at 199.

149 Preamble at 12.

150 2013 Rule § _.20.

151 Preamble at 213–14.

152 Preamble at 225.

153 Preamble at 224–26.

154 Preamble at 225.

155 Preamble at 225.

156 2013 Rule Preamble at 5758.

157 Preamble at 239–41.

158 Appendix at para. III.a. *See also* Preamble at 244.

159 Preamble at 286–88.

160 Preamble at 276, 282, 287.

161 Appendix at para. IV.a.3. *See also* Preamble at 271.

162 Appendix at para. III.b. *See also* Preamble at 245–53.

163 Appendix at para. III.c. *See also* Preamble at 256–60.

164 Preamble at 262.

165 Appendix at para. III.d. *See also* Preamble at 262. Page 57 of Appendix A of this Memorandum contains the changes made to this provision as between the 2013 Rule and the Proposed Rule.

166 Preamble at 17 (Questions #1–2).

167 Preamble at 296–313 (Questions #302–342).

168 Preamble at 38–41 (Questions #3–11).

169 Preamble at 62 (Question #24).

170 Preamble at 62–66 (Questions #23–38).

171 Preamble at 72–74 (Questions #39–48).

172 Preamble at 66, 73–74, 87, 98–99, 114 (Question #38, 44, 47, 63, 76, 95).

173 Preamble at 84–85 (Questions #57–59).

174 Preamble at 82–83.

175 Preamble at 87 (Questions #60–63).

176 Preamble at 95–99 (Questions #64–77).

177 Preamble at 102 (Questions #78–81).

178 Preamble at 111–15 (Questions #82–96).

179 Preamble at 118 (Questions #97–100).

180 Preamble at 122–23 (Questions #101–107).

181 Preamble at 126 (Questions #108–112).

182 Preamble at 135–37 (Questions #113–122).

183 Preamble at 78–79 (Questions #49–51).

184 Preamble at 80–81 (Questions # 52–56).

185 Preamble at 147–50 (Questions #123–130).

186 Preamble at 152–56 (Questions #131–139).

187 Preamble at 176–82 (Questions #160–171).

188 Form PF defines "securitized asset fund" to mean any private fund whose primary purpose is to issue asset-backed securities and whose investors are primarily debtholders.

189 Preamble at 177.

190 Form PF defines (i) "liquidity fund" to mean any private fund that seeks to generate income by investing in a portfolio of short-term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors; (ii) "real estate fund" to mean any private fund that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course and that invests primarily in real estate and real estate-related assets; (iii) "securitized asset fund" to mean any private fund whose primary purpose is to issue asset-backed securities and whose investors are primarily debtholders (as noted at *supra* note 188); and (iv) "venture capital fund" to mean any private fund meeting the definition of venture capital fund in Rule 203(l)-1 under the Investment Advisers Act of 1940. Preamble at 178 n.172.

191 Preamble at 178–79.

192 Preamble at 160–71 (Questions #140–154).

193 Preamble at 173–75 (Questions #155–159).

ENDNOTES (CONTINUED)

194 Preamble at 185–86 (Questions #172–175).

195 Preamble at 185 (Question #173).

196 Preamble at 186–90 (Questions #176–180).

197 Preamble at 190–92 (Questions #181–182).

198 Preamble at 195–97 (Questions #183–185).

199 Preamble at 207–08 (Questions #189–193).

200 Preamble at 212–13 (Questions #194–202).

201 Preamble at 213 (Question #199).

202 Preamble at 212 (Question #195).

203 Preamble at 217 (Question #203).

204 Preamble at 223 (Question #209).

205 Preamble at 228–31 (Questions #210–212).

206 Preamble at 218–20 (Questions #204–208).

207 Preamble at 235 (Question #214).

208 Preamble at 244 (Questions #215–218).

209 Preamble at 289–94 (Questions #285–301).

210 Preamble at 253–63 (Questions #220–244).

211 Preamble at 264–68 (Questions #245–256).

212 Preamble at 270–72 (Questions #257–260).

213 Preamble at 273–75 (Questions #261–262).

214 Preamble at 277–79 (Questions #263–270).

215 Preamble at 284–86 (Questions #271–279).

216 Preamble at 288–89 (Questions #280–284).

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Volcker Rule Implementing Regulations

(Textual Comparison of the 2013 Rule against the Proposed Rule)[1]

Subpart A––Authority and Definitions

§ __.1 Authority, purpose, scope, and relationship to other authorities.

(a) *Authority*. This part (Regulation VV) is issued by the Board under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851), as well as under the Federal Reserve Act, as amended (12 U.S.C. 221 et seq.); section 8 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818); the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 et seq.); and the International Banking Act of 1978, as amended (12 U.S.C. 3101 et seq.).

(b) *Purpose*. Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and on investments in or relationships with covered funds by certain banking entities, including state member banks, bank holding companies, savings and loan holding companies, other companies that control an insured depository institution, foreign banking organizations, and certain subsidiaries thereof. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and on investments in or relationships with covered funds, and explaining the statute's requirements.

(c) *Scope*. This part implements section 13 of the Bank Holding Company Act with respect to banking entities for which the Board is authorized to issue regulations under section 13(b)(2) of the Bank Holding Company Act (12 U.S.C. 1851(b)(2)) and take actions under section 13(e) of that Act (12 U.S.C. 1851(e)). These include any state bank that is a member of the Federal Reserve System, any company that controls an insured depository institution (including a bank holding company and savings and loan holding company), any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act (12 U.S.C. 3106), and any subsidiary of the foregoing other than a subsidiary for which the OCC, FDIC, CFTC, or SEC is the primary financial regulatory agency (as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5301(12)).

(d) *Relationship to other authorities*. Except as otherwise provided under section 13 of the BHC Act or this part, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of BHC Act and this part shall apply to the activities of a banking entity, even if such activities are authorized for the banking entity under other applicable provisions of law.

(e) *Preservation of authority*. Nothing in this part limits in any way the authority of the Board to impose on a banking entity identified in paragraph (c) of this section additional requirements or restrictions with respect to any activity, investment, or relationship covered under section 13 of the Bank Holding Company Act or this part, or additional penalties for violation of this part provided under any other applicable provision of law.

[1] *[N.B.: Section __.1 of this Appendix A is drawn from the Federal Reserve's Regulation VV (12 C.F.R. § 248.1). The remainder of the base text that was used to generate this comparison is drawn from the common rule text of the 2013 Rule.]*

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§ __.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the [Agency] determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

~~(b)~~(c) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

~~(c)~~(d) *Banking entity*.

(1) Except as provided in paragraph (~~c~~d)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (~~c~~d)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraphs (~~c~~d)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraphs (~~c~~d)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

~~(d)~~(e) *Board* means the Board of Governors of the Federal Reserve System.

~~(e)~~(f) *CFTC* means the Commodity Futures Trading Commission.

~~(f)~~(g) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

SC1:4671524.5

~~(g)~~(h) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

~~(h)~~(i) *Derivative*.

(1) Except as provided in paragraph (~~h~~i)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

~~(i)~~(j) *Employee* includes a member of the immediate family of the employee.

~~(j)~~(k) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

~~(k)~~(l) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

~~(l)~~(m) *FDIC* means the Federal Deposit Insurance Corporation.

~~(m)~~(n) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

~~(n)~~(o) *Foreign banking organization* has the same meaning as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized

under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

~~(o)~~(p) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

~~(p)~~(q) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

~~(q)~~(r) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

~~(r)~~(s) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include an insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)).

(t) *Limited trading assets and liabilities* means, with respect to a banking entity, that:

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1,000,000,000; and

(2) The [Agency] has not determined pursuant to § .20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

~~(s)~~(u) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

~~(t)~~(v) *Moderate trading assets and liabilities* means, with respect to a banking entity, that the banking entity does not have significant trading assets and liabilities or limited trading assets and liabilities.

~~(u)~~(w) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

~~(v)~~(x) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(y) *Qualifying foreign banking organization* means a foreign banking organization that qualifies as such under section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(z) *SEC* means the Securities and Exchange Commission.

(aa) *Sale and sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(bb) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(cc) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(dd) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(ee) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(ff) Significant trading assets and liabilities.

(1) Significant trading assets and liabilities means, with respect to a banking entity, that:

(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $10,000,000,000; or

(ii) The [Agency] has determined pursuant to § .20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (3), trading assets and liabilities for purposes of this paragraph (ff) means trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) on a worldwide consolidated basis.

(3)

(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (ff) means the trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) of the combined U.S. operations of the top-tier foreign banking organization

(including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

(ii) For purposes of paragraph (ff)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(gg) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(hh) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ii) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(jj) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

§ __.3 Prohibition on proprietary trading.

(a) *Prohibition*. Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. Proprietary trading means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

(b) *Definition of trading account*. ~~(1)~~ *Trading account* means any account that is used by a banking entity to:

~~(i) Purchase or sell one or more financial instruments principally for the purpose of:~~

~~(A) Short-term resale;~~

~~(B) Benefitting from actual or expected short-term price movements;~~

~~(C) Realizing short-term arbitrage profits; or~~

~~(D) Hedging one or more positions resulting from the purchases or sales of financial instruments described in paragraphs (b)(1)(i)(A), (B), or (C) of this section;~~

~~(2)~~(1)

(i) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk- based capital ratios under the market risk capital rule; or

(ii) With respect to a banking entity that is not, and is not controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or any State, purchase or sell one or more financial instruments that are subject to capital requirements under a market risk framework established by the home-country supervisor that is consistent with the market risk framework published by the Basel Committee on Banking Supervision, as amended from time to time.

~~(3)~~(2) ~~(ii)~~ Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(i)~~(A)~~ Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(ii)~~(B)~~ Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business~~.~~; or

~~(4) (C) Rebuttable presumption for certain purchases and sales. The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale), unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section.~~

(3) Purchase or sell one or more financial instruments, with respect to a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards.

(c) *Presumption of compliance.*

(1) (i) Each trading desk that does not purchase or sell financial instruments for a trading account defined in paragraphs (b)(1) or (b)(2) of this section may calculate the net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

(ii) If the sum of the absolute values of the daily net gain and loss figures determined in accordance with paragraph (c)(1)(i) of this section for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk shall be presumed to be in compliance with the prohibition in paragraph (a) of this section.

(2) The [Agency] may rebut the presumption of compliance in paragraph (c)(1)(ii) of this section by providing written notice to the banking entity that the [Agency] has determined that one or more of the banking entity's activities violates the prohibitions under subpart B.

(3) If a trading desk operating pursuant to paragraph (c)(1)(ii) of this section exceeds the $25 million threshold in that paragraph at any point, the banking entity shall, in accordance with any policies and procedures adopted by the [Agency]:

(i) Promptly notify the [Agency];

(ii) Demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B; and

(iii) Demonstrate, with respect to the trading desk, how the banking entity will maintain compliance with subpart B on an ongoing basis.

(d) *Financial instrument*.

(1) Financial instrument means:

(i) A security, including an option on a security;

(ii) A derivative, including an option on a derivative; or

(iii) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(2) A financial instrument does not include:

(i) A loan;

(ii) A commodity that is not:

(A) An excluded commodity (other than foreign exchange or currency);

(B) (B) A derivative;

(C) (C) A contract of sale of a commodity for future delivery; or

(D) An option on a contract of sale of a commodity for future delivery; or

(iii) Foreign exchange or currency.

(e) *Proprietary trading*. Proprietary trading does not include:

(1) Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(2) Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(3) Any purchase or sale of a security, foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7

U.S.C. 1a(25)), or physically-settled cross-currency swap, by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that, with respect to such financial instruments:

(i) Specifically contemplates and authorizes the particular ~~securities~~financial instruments to be used for liquidity management purposes, the amount, types, and risks of these ~~securities~~financial instruments that are consistent with liquidity management, and the liquidity circumstances in which the particular ~~securities~~financial instruments may or must be used;

(ii) Requires that any purchase or sale of ~~securities~~financial instruments contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any ~~securities~~financial instruments purchased or sold for liquidity management purposes be highly liquid and limited to ~~securities~~financial instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any ~~securities~~financial instruments purchased or sold for liquidity management purposes, together with any other instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of ~~securities~~financial instruments that are not permitted under §§ __.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (~~d~~e)(3) of this section; and

(vi) Is consistent with [Agency]'s supervisory requirements, guidance, and expectations regarding liquidity management;

(4) Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments;

(5) Any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(6) Any purchase or sale of one or more financial instruments by a banking entity, so long as:

(i) The purchase (or sale) satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or

(ii) The purchase (or sale) satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding;

(7) Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian;

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity; or

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the Board.

(10) Any purchase (or sale) of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error, and the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.

~~(e)~~(f) *Definition of other terms related to proprietary trading*. For purposes of this subpart:

(1) *Anonymous* means that each party to a purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale.

(2) *Clearing agency* has the same meaning as in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(3) *Commodity* has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(4) *Contract of sale of a commodity for future delivery* means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27))).

(5) *Cross-currency swap* means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

~~(5)~~(6) *Derivatives clearing organization* means:

(i) A derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1);

(ii) A derivatives clearing organization that, pursuant to CFTC regulation, is exempt from the registration requirements under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1); or

(iii) A foreign derivatives clearing organization that, pursuant to CFTC regulation, is permitted to clear for a foreign board of trade that is registered with the CFTC.

~~(6)~~(7) *Exchange*, unless the context otherwise requires, means any designated contract market, swap execution facility, or foreign board of trade registered with

the CFTC, or, for purposes of securities or security-based swaps, an exchange, as defined under section 3(a)(1) of the Exchange Act (15 U.S.C. 78c(a)(1)), or security-based swap execution facility, as defined under section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)).

~~(7)~~(8) *Excluded clearing activities* means:

(i) With respect to customer transactions cleared on a derivatives clearing organization, a clearing agency, or a designated financial market utility, any purchase or sale necessary to correct trading errors made by or on behalf of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(ii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a designated financial market utility; and

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

~~(8)~~(9) *Designated financial market utility* has the same meaning as in section 803(4) of the Dodd-Frank Act (12 U.S.C. 5462(4)).

~~(9)~~(10) *Issuer* has the same meaning as in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

~~(10)~~(11) *Market risk capital rule covered position and trading position* means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

~~(11)~~(12) *Market risk capital rule* means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

~~(12)~~(13) *Municipal security* means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

~~(13)~~(14) *Trading desk* means the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof.

(g) *Reservation of Authority*:

(1) The [Agency] may determine, on a case-by-case basis, that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account as defined at 12 U.S.C. 1851(h)(6).

(2) Notice and Response Procedures.

(i) Notice. When the [Agency] determines that the purchase or sale of one or more financial instruments is for the trading account under paragraph (g)(1) of this section, the [Agency] will notify the banking entity in writing of the determination and provide an explanation of the determination.

(ii) Response.

(A) The banking entity may respond to any or all items in the notice. The response should include any matters that the banking entity would have the [Agency] consider in deciding whether the purchase or sale is for the trading account. The response must be in writing and delivered to the designated [Agency] official within 30 days after the date on which the banking entity received the notice. The [Agency] may shorten the time period when, in the opinion of the [Agency], the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the [Agency] may extend the time period for good cause.

(B) Failure to respond within 30 days or such other time period as may be specified by the [Agency] shall constitute a waiver of any objections to the [Agency]'s determination.

(iii) After the close of banking entity's response period, the [Agency] will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the [Agency]'s determination that the purchase or sale of one or more financial instruments is for the trading account. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

§ __.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*.

(1) *Permitted underwriting activities*. The prohibition contained in §__.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements*. The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii) (A) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, ~~and~~taking into account the liquidity, maturity, and depth of the market for the relevant type of security, and (B) reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis, and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with paragraph (a)(8)(i) of this section;~~based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:~~

~~*(1)* Amount, types, and risk of its underwriting position;~~

~~*(2)* Level of exposures to relevant risk factors arising from its underwriting position; and~~

~~*(3)* Period of time a security may be held;~~

(C) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(D) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

(iv) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution*. For purposes of this paragraph (a), a distribution of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter*. For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder*. For purposes of this paragraph (a), selling security holder means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position*. For purposes of this paragraph (a), underwriting position means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty*. For purposes of this paragraph (a), the terms *client*, *customer*, and *counterparty*, on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(8) *Rebuttable presumption of compliance*.

(i) *Risk limits*.

(A) A banking entity shall be presumed to meet the requirements of paragraph (a)(2)(ii)(A) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the limits described in paragraph (a)(8)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (8)(i)(A) of this section shall be available with respect to limits for each trading desk that are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's underwriting activities, on the:

(1) Amount, types, and risk of its underwriting position;

(2) Level of exposures to relevant risk factors arising from its underwriting position; and

(3) Period of time a security may be held.

(ii) *Supervisory review and oversight*. The limits described in paragraph (a)(8)(i) of this section shall be subject to supervisory review and oversight by the [Agency] on an ongoing basis. Any review of such limits will include assessment of whether the limits are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (a)(8)(i) of this section, a banking entity shall promptly report to the [Agency] (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the [Agency].

(iv) *Rebutting the presumption*. The presumption in paragraph (a)(8)(i) of this section may be rebutted by the [Agency] if the [Agency] determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The [Agency] will provide notice of any such determination to the banking entity in writing.

(b) *Market making-related activities*—

(1) *Permitted market making-related activities*. The prohibition contained in §__.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements*. The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) ~~The amount, types, and risks of the financial instruments in~~ The trading desk's market-~~maker inventory~~making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on~~:~~

~~(A)~~ the liquidity, maturity, and depth of the market for the relevant types of financial instrument(s)~~; and~~

~~(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;~~

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section,

including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and ~~inventory~~positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, ~~based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by~~ in accordance with paragraph (b)(~~2~~)(ii~~6~~)(i) of this section~~, on:~~;

~~*(1)* The amount, types, and risks of its market-maker inventory;~~

~~*(2)* The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;~~

~~*(3)* The level of exposures to relevant risk factors arising from its financial exposure; and~~

~~*(4)* The period of time a financial instrument may be held;~~

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of this paragraph (b), and independent review of such demonstrable analysis and approval;

(iv) In the case of a banking entity with significant trading assets and liabilities, ~~T~~to the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty*. For purposes of paragraph (b) of this section, the terms *client*, *customer*, and *counterparty*, on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with ~~§ __.20(d)(1) of subpart D~~the methodology described in definition of "significant trading assets and liabilities" contained in § __.2 of this part, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(4) *Definition of financial exposure*. For purposes of this paragraph (b), *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker ~~inventory~~ positions*. For the purposes of this paragraph (b), market-maker ~~inventory~~ positions means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

(6) *Rebuttable presumption of compliance*.

(i) *Risk limits*.

(A) A banking entity shall be presumed to meet the requirements of paragraph (b)(2)(ii) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the limits described in paragraph (b)(6)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (6)(i)(A) of this section shall be available with respect to limits for each trading desk that are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's market making-related activities, on the:

(1) Amount, types, and risks of its market-maker positions;

(2) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(3) Level of exposures to relevant risk factors arising from its financial exposure; and

(4) Period of time a financial instrument may be held.

(ii) *Supervisory review and oversight*. The limits described in paragraph (b)(6)(i) of this section shall be subject to supervisory review and oversight by the [Agency] on an ongoing basis. Any review of such limits will include assessment of whether the limits are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (b)(6)(i) of this section, a banking entity shall promptly report to the [Agency] (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s) , in each case in the form and manner as directed by the [Agency].

(iv) *Rebutting the presumption*. The presumption in paragraph (b)(6)(i) of this section may be rebutted by the [Agency] if the [Agency] determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The [Agency] will provide notice of any such determination to the banking entity in writing.

§ __.5 Permitted risk-mitigating hedging activities.

(a) *Permitted risk-mitigating hedging activities*. The prohibition contained in §__.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) *Requirements*.

(1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

~~(1)~~(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

~~(i)~~(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

~~(ii)~~(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

~~(iii)~~(C) The conduct of analysis~~, including correlation analysis,~~ and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to ~~demonstrably~~ reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged~~, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged~~;

~~(2)~~(ii) The risk-mitigating hedging activity:

~~(i)~~(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

~~(ii)~~(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate ~~and demonstrably reduces or otherwise significantly mitigates~~ one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising

in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

~~(iii)~~ (C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

~~(iv)~~(D) Is subject to continuing review, monitoring and management by the banking entity that:

~~(A)~~*(1)* Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

~~(B)~~*(2)* Is designed to reduce or otherwise significantly mitigate ~~and demonstrably reduces or otherwise significantly mitigates~~ the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

~~(C)~~*(3)* Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(~~2~~1)(ii) of this section and is not prohibited proprietary trading; and

~~(3)~~(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk- mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) *Documentation requirement*.

(1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

(i) Not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce;

(ii) Established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but that is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures established under paragraph (b)(1) of this section or under §__.4(b)(2)(iii)(B) of this subpart as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or

(iii) Established to hedge aggregated positions across two or more trading desks.

(2) In connection with any purchase or sale identified in paragraph (c)(1) of this section, a banking entity must, at a minimum, and contemporaneously with the purchase or sale, document:

(i) The specific, identifiable risk(s) of the identified positions, contracts, or other holdings of the banking entity that the purchase or sale is designed to reduce;

(ii) The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and

(iii) The trading desk or other business unit that is establishing and responsible for the hedge.

(3) A banking entity must create and retain records sufficient to demonstrate compliance with the requirements of this paragraph (c) for a period that is no less than five years in a form that allows the banking entity to promptly produce such records to the Board on request, or such longer period as required under other law or this part.

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The hedging limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

§ __.6 Other permitted proprietary trading activities.

(a) *Permitted trading in domestic government obligations*. The prohibition contained in §__.3(a) does not apply to the purchase or sale by a banking entity of a financial instrument that is:

(1) An obligation of, or issued or guaranteed by, the United States;

(2) An obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, 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.);

(3) An obligation of any State or any political subdivision thereof, including any municipal security; or

(4) An obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(b) *Permitted trading in foreign government obligations*.

(1) *Affiliates of foreign banking entities in the United State*s. The prohibition contained in §__.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as:

(i) The banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in paragraph (b)(1)(i) of this section is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The purchase or sale as principal is not made by an insured depository institution.

(2) *Foreign affiliates of a U.S. banking entity*. The prohibition contained in §__.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as:

(i) The foreign entity is a foreign bank, as defined in section 211.2(j) of the Board's Regulation K (12 CFR 211.2(j)), or is regulated by the foreign sovereign as a securities dealer;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

(c) *Permitted trading on behalf of customers*.

(1) *Fiduciary transactions*. The prohibition contained in §__.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as trustee or in a similar fiduciary capacity, so long as:

(i) The transaction is conducted for the account of, or on behalf of, a customer; and

(ii) The banking entity does not have or retain beneficial ownership of the financial instruments.

(2) *Riskless principal transactions*. The prohibition contained in §__.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(d) *Permitted trading by a regulated insurance company*. The prohibition contained in §__.3(a) does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if:

(1) The insurance company or its affiliate purchases or sells the financial instruments solely for:

(i) The general account of the insurance company; or

(ii) A separate account established by the insurance company;

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

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (d)(2) of this section is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

(e) *Permitted trading activities of foreign banking entities*.

(1) The prohibition contained in §__.3(a) does not apply to the purchase or sale of financial instruments by a banking entity if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State;

(ii) The purchase or sale by the banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale meets the requirements of paragraph (e)(3) of this section.

(2) A purchase or sale of financial instruments by a banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (e)(1)(ii) of this section only if:

(i) The purchase or sale is conducted in accordance with the requirements of paragraph (e) of this section; and

(ii) (A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of any State and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including ~~any~~relevant personnel ~~of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale~~) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;.

~~(iv) No financing for the banking entity's purchases or sales is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and~~

~~(v) The purchase or sale is not conducted with or through any U.S. entity, other than:~~

~~(A) A purchase or sale with the foreign operations of a U.S. entity if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;~~

~~(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or~~

~~(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty;.~~

(4) For purposes of this paragraph (e), a U.S. entity is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this paragraph (e), a U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

~~(6) For purposes of this paragraph (e), unaffiliated market intermediary means an unaffiliated entity, acting as an intermediary, that is:~~

~~(i) A broker or dealer registered with the SEC under section 15 of the Exchange Act or exempt from registration or excluded from regulation as such;~~

~~(ii) A swap dealer registered with the CFTC under section 4s of the Commodity Exchange Act or exempt from registration or excluded from regulation as such;~~

~~(iii) A security-based swap dealer registered with the SEC under section 15F of the Exchange Act or exempt from registration or excluded from regulation as such; or~~

~~(iv) A futures commission merchant registered with the CFTC under section 4f of the Commodity Exchange Act or exempt from registration or excluded from regulation as such.~~

§ __.7 Limitations on permitted proprietary trading activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§__.4 through __.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest*.

(1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure*.

(A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers*. Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy*. For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§§ __.8__.-.9 [Reserved]

Subpart C—Covered Funds Activities and Investments

§ __.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) *Prohibition*.

(1) Except as otherwise provided in this subpart, a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(2) Paragraph (a)(1) of this section does not include acquiring or retaining an ownership interest in a covered fund by a banking entity:

(i) Acting solely as agent, broker, or custodian, so long as;

(A) The activity is conducted for the account of, or on behalf of, a customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest;

(ii) Through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof) that is established and administered in accordance with the law of the United States or a foreign sovereign, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);

(iii) In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event may the banking entity retain such ownership interest for longer than such period permitted by the Board; or

(iv) On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as:

(A) The activity is conducted for the account of, or on behalf of, the customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest.

(b) *Definition of covered fund*. (1) Except as provided in paragraph (c) of this section, covered fund means:

(i) 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) or (7));

(ii) Any commodity pool under section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10)) for which:

(A) The commodity pool operator has claimed an exemption under 17 CFR 4.7; or

(B) *(1)* A commodity pool operator is registered with the CFTC as a commodity pool operator in connection with the operation of the commodity pool;

(2) Substantially all participation units of the commodity pool are owned by qualified eligible persons under 17 CFR 4.7(a)(2) and (3); and

(3) Participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons under 17 CFR 4.7(a)(2) and (3); or

(iii) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, an entity that:

(A) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(B) Is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities; and

(C) *(1)* Has as its sponsor that banking entity (or an affiliate thereof); or

(2) Has issued an ownership interest that is owned directly or indirectly by that banking entity (or an affiliate thereof).

(2) An issuer shall not be deemed to be a covered fund under paragraph (b)(1)(iii) of this section if, were the issuer subject to U.S. securities laws, the issuer could rely on an exclusion or exemption from the definition of "investment company" under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act.

(3) For purposes of paragraph (b)(1)(iii) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(c) Notwithstanding paragraph (b) of this section, unless the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine otherwise, a covered fund does not include:

(1) *Foreign public funds*.

(i) Subject to paragraphs (ii) and (iii) below, an issuer that:

(A) Is organized or established outside of the United States;

(B) Is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and

(C) Sells ownership interests predominantly through one or more public offerings outside of the United States.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and employees of such entities.

(iii) For purposes of paragraph (c)(1)(i)(C) of this section, the term "public offering" means a distribution (as defined in §__.4(a)(3) of subpart B) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(B) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(C) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

(2) *Wholly-owned subsidiaries*. An entity, all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate thereof), except that:

(i) Up to five percent of the entity's outstanding ownership interests, less any amounts outstanding under paragraph (c)(2)(ii) of this section, may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and

(ii) Up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(3) *Joint ventures*. A joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, provided that the joint venture:

(i) Is comprised of no more than 10 unaffiliated co-venturers;

(ii) Is in the business of engaging in activities that are permissible for the banking entity or affiliate, other than investing in securities for resale or other disposition; and

(iii) Is not, and does not hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities.

(4) *Acquisition vehicles*. An issuer:

(i) Formed solely for the purpose of engaging in a bona fide merger or acquisition transaction; and

(ii) That exists only for such period as necessary to effectuate the transaction.

(5) *Foreign pension or retirement funds*. A plan, fund, or program providing pension, retirement, or similar benefits that is:

(i) Organized and administered outside the United States;

(ii) A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and

(iii) Established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.

(6) *Insurance company separate accounts*. A separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses.

(7) *Bank owned life insurance*. A separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is beneficiary, provided that no banking entity that purchases the policy:

(i) Controls the investment decisions regarding the underlying assets or holdings of the separate account; or

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank owned life insurance.

(8) *Loan securitizations*.

(i) *Scope*. An issuing entity for asset-backed securities that satisfies all the conditions of this paragraph (c)(8) and the assets or holdings of which are comprised solely of:

(A) Loans as defined in §__.2(~~s~~u) of subpart A;

(B) Rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset meets the requirements of paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(ii) *Impermissible assets*. For purposes of this paragraph (c)(8), the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraph (c)(8)(iii) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities*. Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives*. The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivative directly relate to the loans, the asset-backed securities, or the contractual rights of other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates*. The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in this paragraph (c)(8);

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under this paragraph (c)(8) and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

(9) *Qualifying asset-backed commercial paper conduits*.

(i) An issuing entity for asset-backed commercial paper that satisfies all of the following requirements:

(A) The asset-backed commercial paper conduit holds only:

(1) Loans and other assets permissible for a loan securitization under paragraph (c)(8)(i) of this section; and

(2) Asset-backed securities supported solely by assets that are permissible for loan securitizations under paragraph (c)(8)(i) of this section and acquired by the asset-backed commercial paper conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or directly from an underwriter in the distribution of the asset-backed securities;

(B) The asset-backed commercial paper conduit issues only asset-backed securities, comprised of a residual interest and securities with a legal maturity of 397 days or less; and

(C) A regulated liquidity provider has entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the

outstanding asset-backed securities issued by the asset-backed commercial paper conduit (other than any residual interest) in the event that funds are required to redeem maturing asset-backed securities.

(ii) For purposes of this paragraph (c)(9), a regulated liquidity provider means:

(A) A depository institution, as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(B) A bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a subsidiary thereof;

(C) A savings and loan holding company, as defined in section 10a of the Home Owners' Loan Act (12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), or a subsidiary thereof;

(D) A foreign bank whose home country supervisor, as defined in §211.21(q) of the Board's Regulation K (12 CFR 211.21(q)), has adopted capital standards consistent with the Capital Accord for the Basel Committee on banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(E) The United States or a foreign sovereign.

(10) *Qualifying covered bonds.*

(i) *Scope*. An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are comprised solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

(ii) *Covered bond*. For purposes of this paragraph (c)(10), a covered bond means:

(A) A debt obligation issued by an entity that meets the definition of foreign banking organization, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section; or

(B) A debt obligation of an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section, provided that the payment obligations are fully and unconditionally guaranteed by an entity that meets the definition of foreign banking organization and the entity is a wholly-owned subsidiary, as defined in paragraph (c)(2) of this section, of such foreign banking organization.

(11) *SBICs and public welfare investment funds*. An issuer:

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked; or

(ii) The business of which is to make investments that are:

(A) Designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United

States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(12) *Registered investment companies and excluded entities*. An issuer:

(i) That is registered as an investment company under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), or that is formed and operated pursuant to a written plan to become a registered investment company as described in §__.20(e)(3) of subpart D and that complies with the requirements of section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a-18);

(ii) That may rely on an exclusion or exemption from the definition of "investment company" under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act; or

(iii) That has elected to be regulated as a business development company pursuant to section 54(a) of that Act (15 U.S.C. 80a-53) and has not withdrawn its election, or that is formed and operated pursuant to a written plan to become a business development company as described in §__.20(e)(3) of subpart D and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a-60).

(13) *Issuers in conjunction with the FDIC's receivership or conservatorship operations*. An issuer that is an entity formed by or on behalf of the FDIC for the purpose of facilitating the disposal of assets acquired in the FDIC's capacity as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(14) *Other excluded issuers*.

(i) Any issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act.

(ii) A determination made under paragraph (c)(14)(i) of this section will be promptly made public.

(d) *Definition of other terms related to covered funds*. For purposes of this subpart:

~~(1) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the [Agency] determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.~~

~~(2)~~(1) *Asset-backed security* has the meaning specified in Section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79).

~~(3)~~(2) *Director* has the same meaning as provided in section 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

~~(4)~~(3) *Issuer* has the same meaning as in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(22)).

~~(5)~~(4) *Issuing entity* means with respect to asset-backed securities the special purpose vehicle that owns or holds the pool assets underlying asset-backed securities and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

~~(6)~~(5) *Ownership interest*.

(i) *Ownership interest* means any equity, partnership, or other similar interest. An "other similar interest" means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs (d)(~~6~~5)(i)(A) through (F) of this section.

(ii) *Ownership interest* does not include: *Restricted profit interest*. An interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(A) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(B) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such

undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(C) Any amounts invested in the covered fund, including any amounts paid by the entity (or employee or former employee thereof) in connection with obtaining the restricted profit interest, are within the limits of §__.12 of this subpart; and

(D) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

~~(7)~~(6) *Prime brokerage transaction* means any transaction that would be a covered transaction, as defined in section 23A(b)(7) of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), that is provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, or data, operational, and administrative support.

~~(8)~~(7) *Resident of the United States* means a person that is a "U.S. person" as defined in rule 902(k) of the SEC's Regulation S (17 CFR 230.902(k)).

~~(9)~~(8) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

(ii) 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 covered fund; or

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

~~(10)~~(9) *Trustee*.

(i) For purposes of paragraph (d)(~~9~~8) of this section and §__.11 of subpart C, a trustee does not include:

(A) A trustee that does not exercise investment discretion with respect to a covered fund, including a trustee that is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)); or

(B) A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to those described in paragraph (d)(~~10~~9)(i)(A) of this section;

(ii) Any entity that directs a person described in paragraph (d)(~~10~~9)(i) of this section, or that possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee, shall be considered to be a trustee of such covered fund.

§ __.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

(a) *Organizing and offering a covered fund in general*. Notwithstanding §__.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund in connection with, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered 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 covered fund, including any necessary expenses for the foregoing, only if:

(1) The banking entity (or an affiliate thereof) provides bona fide trust, fiduciary, investment advisory, or commodity trading advisory services;

(2) The covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity (or an affiliate thereof), pursuant to a written plan or similar documentation outlining how the banking entity or such affiliate intends to provide advisory or similar services to its customers through organizing and offering such fund;

(3) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under §__.12 of this subpart;

(4) The banking entity and its affiliates comply with the requirements of §__.14 of this subpart;

(5) The banking entity and its affiliates do not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests;

(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof); and

(ii) Does not use the word "bank" in its name;

(7) No director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity or such affiliate who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

(8) The banking entity:

(i) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(A) That "any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity] or its affiliates; therefore, [the banking entity's] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity] and any affiliate in its

capacity as investor in the [covered fund] or as beneficiary of a restricted profit interest held by [the banking entity] or any affiliate";

(B) That such investor should read the fund offering documents before investing in the covered fund;

(C) That the "ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity" (unless that happens to be the case); and

(D) The role of the banking entity and its affiliates and employees in sponsoring or providing any services to the covered fund; and

(ii) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates.

(b) *Organizing and offering an issuing entity of asset-backed securities*.

(1) Notwithstanding §__.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuing entity of asset-backed securities in connection with, directly or indirectly, organizing and offering that issuing entity, so long as the banking entity and its affiliates comply with all of the requirements of paragraph (a)(3) through (8) of this section.

(2) For purposes of this paragraph (b), organizing and offering a covered fund that is an issuing entity of asset-backed securities means acting as the securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o-11(a)(3)) of the issuing entity, or acquiring or retaining an ownership interest in the issuing entity as required by section 15G of that Act (15 U.S.C.78o-11) and the implementing regulations issued thereunder.

(c) *Underwriting and market making in ownership interests of a covered fund*. The prohibition contained in § __.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § __.4(a) or § __.4(b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o- 11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78o-11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section~~; or, directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests~~, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § __.12(a)(2)(ii); § __.12(a)(2)(iii), and § __.12(d) of this subpart~~; and~~,

~~(3) With respect to any banking entity, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under §__.11 of this subpart, including all covered funds in which the banking entity holds an ownership interest in connection with underwriting and market making related activities permitted under this paragraph (c), are included in the calculation of all ownership interests under §__.12(a)(2)(iii) and §__.12(d) of this subpart.~~

§ __.12 Permitted investment in a covered fund.

(a) *Authority and limitations on permitted investments in covered funds*.

(1) Notwithstanding the prohibition contained in § __.10(a) of this subpart, a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity or an affiliate thereof organizes and offers pursuant to § __.11, for the purposes of:

(i) *Establishment*. Establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, subject to the limits contained in paragraphs (a)(2)(i) and (iii) of this section; or

(ii) *De minimis investment*. Making and retaining an investment in the covered fund subject to the limits contained in paragraphs (a)(2)(ii) and (iii) of this section.

(2) *Investment limits*.

(i) *Seeding period*. With respect to an investment in any covered fund made or held pursuant to paragraph (a)(1)(i) of this section, the banking entity and its affiliates:

(A) Must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) Must, no later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section), conform its ownership interest in the covered fund to the limits in paragraph (a)(2)(ii) of this section;

(ii) *Per-fund limits.*

(A) Except as provided in paragraph (a)(2)(ii)(B) of this section, an investment by a banking entity and its affiliates in any covered fund made or held pursuant to paragraph (a)(1)(ii) of this section may not exceed 3 percent of the total number or value of the outstanding ownership interests of the fund.

(B) An investment by a banking entity and its affiliates in a covered fund that is an issuing entity of asset-backed securities may not exceed 3 percent of the total fair market value of the ownership interests of the fund measured in accordance with paragraph (b)(3) of this section, unless a greater percentage is retained by the banking entity and its affiliates in compliance with the requirements of section 15G of the Exchange Act (15 U.S.C. 78o-11) and the implementing regulations issued thereunder, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the

amount, number, or value of ownership interests of the fund required under section 15G of the Exchange Act and the implementing regulations issued thereunder.

(iii) *Aggregate limit*. The aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired or retained under this section may not exceed 3 percent of the tier 1 capital of the banking entity, as provided under paragraph (c) of this section, and shall be calculated as of the last day of each calendar quarter.

(iv) *Date of establishment*. For purposes of this section, the date of establishment of a covered fund shall be:

(A) *In general*. The date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund;

(B) *Issuing entities of asset-backed securities*. In the case of an issuing entity of asset-backed securities, the date on which the assets are initially transferred into the issuing entity of asset-backed securities.

(b) *Rules of construction*.

(1) *Attribution of ownership interests to a covered banking entity*.

(i) For purposes of paragraph (a)(2) of this section, the amount and value of a banking entity's permitted investment in any single covered fund shall include any ownership interest held under § __.12 directly by the banking entity, including any affiliate of the banking entity.

(ii) *Treatment of registered investment companies, SEC-regulated business development companies and foreign public funds*. For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies or foreign public fund as described in § __.10(c)(1) of this subpart will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

(iii) *Covered funds*. For purposes of paragraph (b)(1)(i) of this section, a covered fund will not be considered to be an affiliate of a banking entity so long as the covered fund is held in compliance with the requirements of this subpart.

(iv) *Treatment of employee and director investments financed by the banking entity*. For purposes of paragraph (b)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires an ownership interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(2) *Calculation of permitted ownership interests in a single covered fund*. Except as provided in paragraph (b)(3) or (4), for purposes of determining whether an

investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(A) of this section:

(i) The aggregate number of the outstanding ownership interests held by the banking entity shall be the total number of ownership interests held under this section by the banking entity in a covered fund divided by the total number of ownership interests held by all entities in that covered fund, as of the last day of each calendar quarter (both measured without regard to committed funds not yet called for investment);

(ii) The aggregate value of the outstanding ownership interests held by the banking entity shall be the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity, divided by the value of all investments in and capital contributions made to that covered fund by all entities, as of the last day of each calendar quarter (all measured without regard to committed funds not yet called for investment). If fair market value cannot be determined, then the value shall be the historical cost basis of all investments in and contributions made by the banking entity to the covered fund;

(iii) For purposes of the calculation under paragraph (b)(2)(ii) of this section, once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards.

(3) *Issuing entities of asset-backed securities*. In the case of an ownership interest in an issuing entity of asset-backed securities, for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(B) of this section:

(i) For securitizations subject to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o-11), the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o-11) and the implementing regulations issued thereunder; or

(ii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the calculations shall be made as of the date of establishment as defined in paragraph (a)(2)(iv)(B) of this section or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund, and thereafter only upon the date on which additional securities of the issuing entity of asset-backed securities are priced for purposes of the sales of ownership interests to unaffiliated investors.

(iii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

(iv) For purposes of the calculation under paragraph (b)(3)(iii) of this section, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards.

(4) *Multi-tier fund investments*.

(i) *Master-feeder fund investments*. If the principal investment strategy of a covered fund (the "feeder fund") is to invest substantially all of its assets in another single covered fund (the "master fund"), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest of the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments*. If a banking entity organizes and offers a covered fund pursuant to § __.11 of this subpart for the purpose of investing in other covered funds (a "fund of funds") and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest of the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(c) *Aggregate permitted investments in all covered funds*.

(1) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § __.10(d)(~~6~~5)(ii) of this subpart), on a historical cost basis.

(2) *Calculation of tier 1 capital*. For purposes of paragraph (a)(2)(iii) of this section:

(i) *Entities that are required to hold and report tier 1 capital*. If a banking entity is required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be equal to the amount of tier 1 capital of the banking entity as of the last day of the most recent calendar quarter, as reported to its primary financial regulatory agency; and

(ii) If a banking entity is not required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, be equal to the amount of tier 1 capital reported by such controlling depository institution in the manner described in paragraph (c)(2)(i) of this section;

(B) In the case of a banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(1) Bank holding company subsidiaries. If the banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, be equal to the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital in the manner described in paragraph (c)(2)(i) of this section; and

(2) Other holding companies and any subsidiary or affiliate thereof. If the banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, be equal to the total amount of

shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(iii) *Treatment of foreign banking entities*.

(A) *Foreign banking entities*. Except as provided in paragraph (c)(2)(iii)(B) of this section, with respect to a banking entity that is not itself, and is not controlled directly or indirectly by, a banking entity that is located or organized under the laws of the United States or of any State, the tier 1 capital of the banking entity shall be the consolidated tier 1 capital of the entity as calculated under applicable home country standards.

(B) *U.S. affiliates of foreign banking entities*. With respect to a banking entity that is located or organized under the laws of the United States or of any State and is controlled by a foreign banking entity identified under paragraph (c)(2)(iii)(A) of this section, the banking entity's tier 1 capital shall be as calculated under paragraphs (c)(2)(i) or (ii) of this section.

(d) *Capital treatment for a permitted investment in a covered fund*. For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § __.10(d)(~~6~~5)(ii) of subpart C), on a historical cost basis, plus any earnings received; and

(2) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (b)(3) of this section (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § __.10(d)(~~6~~5)(ii) of subpart C), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(e) *Extension of time to divest an ownership interest*.

(1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(2) *Factors governing the Board determinations*. In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;

(v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;

(vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;

(vii) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;

(viii) Market conditions; and

(ix) Any other factor that the Board believes appropriate.

(3) *Authority to impose restrictions on activities or investment during any extension period*. The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(4) *Consultation*. In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

§ __.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities*.

(1) The prohibition contained in § __.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to ~~demonstrably~~ reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund~~.~~; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

~~(1)~~(2) *Requirements*. The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program ~~required by~~ in accordance with subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate ~~and demonstrably reduces or otherwise significantly mitigates~~ one or more specific, identifiable risks arising (1) out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund or (2) in connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) With respect to risk-mitigating hedging activity conducted pursuant to paragraph (a)(1)(i), the compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to ~~this~~ paragraph (a)(1)(i) and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) *Certain permitted covered fund activities and investments outside of the United States*.

(1) The prohibition contained in § __.10(a) of this subpart does not apply to the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a banking entity only if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in the covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity or investment occurs solely outside of the United States.

(2) An activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (b)(1)(ii) of this section only if:

(i) The activity or investment is conducted in accordance with the requirements of this section; and

(ii) (A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of one or more States and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is ~~sold or has been sold pursuant to an offering that does not target residents of the United States~~ not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of this paragraph (b)(3) to participate in any offer or sale by the covered fund of ownership interests in the covered fund.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal

directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.~~; and~~

~~(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.~~

(5) For purposes of this section, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States; however, a foreign bank of which that branch, agency, or subsidiary is a part is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

(c) *Permitted covered fund interests and activities by a regulated insurance company*. The prohibition contained in § __.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

§ __.14 Limitations on relationships with a covered fund.

(a) *Relationships with a covered fund*.

(1) Except as provided for in paragraph (a)(2) of this section, no banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, that organizes and offers a covered fund pursuant to § __.11 of this subpart, or that continues to hold an ownership interest in accordance with § __.11(b) of this subpart, and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of § __.11, § __.12, or § __.13 of this subpart; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate thereof) has taken an ownership interest, if:

(A) The banking entity is in compliance with each of the limitations set forth in § __.11 of this subpart with respect to a covered fund organized and offered by such banking entity (or an affiliate thereof);

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the [Agency] (with a duty to update the certification if the information in the certification materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

(b) *Restrictions on transactions with covered funds*. A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § __.11 of this subpart, or that continues to hold an ownership interest in accordance with § __.11(b) of this subpart, shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c-1), as if such banking entity were a member bank and such covered fund were an affiliate thereof.

(c) *Restrictions on prime brokerage transactions*. A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c-1) as if the counterparty were an affiliate of the banking entity.

§ __.15 Other limitations on permitted covered fund activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ __.11 through __.13 of this subpart if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest*. (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure*.

(A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers*. Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy*. For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§ __.16 Ownership of interests in and sponsorship of issuers of certain collateralized debt obligations backed by trust-preferred securities.

(a) The prohibition contained in § __.10(a)(1) does not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer if:

(1) The issuer was established, and the interest was issued, before May 19, 2010;

(2) The banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral; and

(3) The banking entity acquired such interest on or before December 10, 2013 (or acquired such interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before December 10, 2013).

(b) For purposes of this § __.16, Qualifying TruPS Collateral shall mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt

instrument, had total consolidated assets of less than $15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company.

(c) Notwithstanding paragraph (a)(3) of this section, a banking entity may act as a market maker with respect to the interests of an issuer described in paragraph (a) of this section in accordance with the applicable provisions of §§ __.4 and __.11.

(d) Without limiting the applicability of paragraph (a) of this section, the Board, the FDIC and the OCC will make public a non-exclusive list of issuers that meet the requirements of paragraph (a). A banking entity may rely on the list published by the Board, the FDIC and the OCC.

[79 FR 5227, 5228, Jan. 31, 2014]

§§ __.17-.19 [Reserved]

SUBPART D-–Compliance Program Requirement; Violations

§ __.20 Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities.* With respect to a banking entity with significant trading assets and liabilities~~*Contents of compliance program.* Except as provided in paragraph (f) of this section~~, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities subject to subpart B (including those permitted under §§ __.3 to __.6 of subpart B), including setting, monitoring and managing required limits set out in §§ __.4 and __.5, and activities and investments with respect to a covered fund subject to subpart C (including those permitted under §§ __.11 through __.14 of subpart C) conducted by the banking entity to ensure that all activities and investments conducted by the banking entity that are subject to section 13 of the BHC Act and this part comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and this part and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in this part or by management as requiring attention;

(4) Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a banking entity must promptly provide to the Board upon request and retain for a period of no less than 5 years or such longer period as required by the Board.

(c) *CEO attestation.* ~~Additional Standards. In addition to the requirements in paragraph (b) of this section, the compliance program of a banking entity must satisfy the requirements and other standards contained in Appendix B, if:~~

(1) The CEO of a banking entity described in paragraph (2) must, based on a review by the CEO of the banking entity, attest in writing to the [Agency], each year no later than March 31, that the banking entity has in place processes reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States. ~~The banking entity engages in proprietary trading permitted under subpart B and is required to comply with the reporting requirements of paragraph (d) of this section;~~

~~(2) the banking entity has reported total consolidated assets as of the previous calendar year end of $50 billion or more or, In the case of a foreign banking entity, has total U.S. assets as of the previous calendar year end of $50 billion or more (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States); or~~

(2) The requirements of paragraph (c)(1) apply to a banking entity if:

(i) The banking entity does not have limited trading assets and liabilities; or

(ii)~~(3)~~ The [Agency] notifies the banking entity in writing that it must satisfy the requirements ~~and other standards~~ contained in ~~appendix B to this part.~~paragraph (c)(1).

(d) *Reporting requirements under ~~appendix A~~the Appendix to this part.*

(1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in ~~appendix A~~the Appendix, if:

(i) The banking entity has significant trading assets and liabilities; or

~~(i) The banking entity (other than a foreign banking entity as provided in paragraph (d)(1)(ii) of this section) has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section;~~

~~(ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section; or~~

~~(iii)~~(ii) The [Agency] notifies the banking entity in writing that it must satisfy the reporting requirements contained in ~~appendix A~~the Appendix.

~~(3)~~(2) Frequency of reporting: Unless the [Agency] notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with ~~paragraph (d)(1)~~the methodology described in the definition of "significant trading assets and liabilities" contained in § __.2 of this ~~section~~part of this part) shall report the information required by ~~appendix A~~the Appendix for each calendar month within ~~30 days of the end of the relevant calendar month; beginning with information for the month of January 2015, such information shall be reported within 10~~20 days of the end of each calendar month. Any other banking entity subject to ~~appendix A~~the Appendix shall report the information required by ~~appendix A~~the Appendix for each calendar quarter within 30 days of the end of that calendar quarter unless the [Agency] notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* ~~Any~~A banking entity ~~that has more than $10 billion in total consolidated~~with significant trading assets ~~as reported on December 31 of the previous two calendar years~~and liabilities shall maintain records that include:

(1) Documentation of the exclusions or exemptions other than sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund;

(2) For each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of covered fund provided by §§ __.10(c)(1),__.10(c)(5), __.10(c)(8), __.10(c)(9), or __.10(c)(10) of subpart C, documentation supporting the banking entity's determination that the fund is not a covered fund pursuant to one or more of those exclusions;

(3) For each seeding vehicle described in § __.10(c)(12)(i) or (iii) of subpart C that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § __.12(a)(2)(i)(B) of subpart C;

(4) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, if the aggregate amount of ownership interests in foreign public funds that are described in § __.10(c)(1) of subpart C owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in

or organized under the laws of the United States or of any State) exceeds $50 million at the end of two or more consecutive calendar quarters, beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar quarter, which documentation must continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters; and

(5) For purposes of paragraph (e)(4) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(f) *Simplified programs for less active banking entities*.

(1) *Banking entities with no covered activities*. A banking entity that does not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B) may satisfy the requirements of this section by establishing the required compliance program prior to becoming engaged in such activities or making such investments (other than trading activities permitted pursuant to § __.6(a) of subpart B).

(2) *Banking entities with ~~modest activities.~~ moderate trading assets and liabilities*. A banking entity with ~~total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engages in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted under § .6(a) of subpart B)~~moderate trading assets and liabilities may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.

(g) *Rebuttable presumption of compliance for banking entities with limited trading assets and liabilities.*

(1) *Rebuttable presumption*. Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities shall be presumed to be compliant with subpart B and subpart C and shall have no obligation to demonstrate compliance with this part on an ongoing basis.

(2) *Rebuttal of presumption.*

(i) If upon examination or audit, the [Agency] determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C, the [Agency] may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities.

(ii) *Notice and Response Procedures.*

(A) *Notice*. The [Agency] will notify the banking entity in writing of any determination pursuant to paragraph (g)(2)(i) of this section to rebut the presumption described in this paragraph (g) and will provide an explanation of the determination.

(B) *Response.*

(I) The banking entity may respond to any or all items in the notice described in paragraph (g)(2)(ii)(A) of this section. The response should include any matters that the banking entity would have the [Agency] consider in deciding whether the banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The response must be in writing and delivered to the designated [Agency] official within 30 days after the date on which the banking entity received the notice. The [Agency] may shorten the time period when, in the opinion of the [Agency], the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the [Agency] may extend the time period for good cause.

(II) Failure to respond within 30 days or such other time period as may be specified by the [Agency] shall constitute a waiver of any objections to the [Agency]'s determination.

(C) After the close of banking entity's response period, the [Agency] will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the [Agency]'s determination that banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

(h) *Reservation of authority*. Notwithstanding any other provision of this part, the [Agency] retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the [Agency] determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C, does not warrant a presumption of compliance under paragraph (g) of this section or treatment as a banking entity with moderate trading assets and liabilities, as applicable.

§ __.21 Termination of activities or investments; penalties for violations.

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the Board finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or this part, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or this part, the Board may take any action permitted by law to enforce compliance with section 13 of the BHC Act and this part, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

Appendix ~~A~~ to Part __ —Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B ("proprietary trading restrictions"). Pursuant to § __.20(d), this appendix ~~generally~~ applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the [Agency] regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § __.20 ~~and Appendix B~~.

b. The purpose of this appendix is to assist banking entities and the [Agency] in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § __.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ __.4, __.5, or __.6(a)-(b) (i.e., underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the [Agency] of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. ~~The quantitative measurements~~Information that must be furnished pursuant to this appendix ~~are~~is *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

~~In order to allow banking entities and the Agencies to evaluate the effectiveness of these metrics, banking entities must collect and report these metrics for all trading desks beginning on the dates established in §.20 of the final rule. The Agencies will review the data collected and revise this collection requirement as appropriate based on a review of the data collected prior to September 30, 2015.~~

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by §~~.20 and Appendix B~~

~~to this part.~~ __.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ __.4 through __6(a)-(b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the [Agency], and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ __.2 and __.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ __.4, __.5, __.6(a), or __.6(b). A banking entity may include in its covered trading activity trading conducted under §§ _.3(~~d~~), e), __.6(c), __.6(d), or __.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

~~*Trading desk means the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof.*~~

~~*III.*~~ *Trading day* means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping ~~of Quantitative Measurements~~

a. ~~**A.** **Scope of Required Reporting**~~

1. ~~*General scope.*~~*Quantitative measurements*. Each banking entity made subject to this ~~part~~appendix by § __.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity, ~~calculated~~ engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

- ~~•~~ Risk and Position Limits and Usage;
- ~~•~~ Risk Factor Sensitivities;
- ~~•~~ Value-at-Risk and ~~Stress VaR~~Stressed Value-at-Risk;
- ~~•~~ Comprehensive Profit and Loss Attribution;
- ~~•~~ Positions;
- Transaction Volumes; and
- Securities Inventory Aging~~; and~~,
- ~~*Customer-Facing Trade Ratio*~~

2. *Trading desk information*. Each banking entity made subject to this appendix by § ___.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. *Quantitative measurements identifying information*. Each banking entity made subject to this appendix by § _.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. *Narrative statement*. Each banking entity made subject to this appendix by § _.20 must provide a separate narrative statement, as further described in this appendix.

5. *File identifying information*. Each banking entity made subject to this appendix by § __.20 must provide file identifying information in each submission to the [Agency] pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. ***Trading Desk Information***

Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

- Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;
- Identification of each type of covered trading activity in which the trading desk is engaged;
- Brief description of the general strategy of the trading desk;
- A list of the types of financial instruments and other products purchased and sold by the trading desk; an indication of which of these are the main financial instruments or products purchased and sold by the trading desk; and, for trading desks engaged in market making-related activities under § __.4(b), specification of whether each type of financial instrument is included in

market-maker positions or not included in market- maker positions. In addition, indicate whether the trading desk is including in its quantitative measurements products excluded from the definition of "financial instrument" under § __.3(d)(2) and, if so, identify such products;

- Identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and indication of which of the identified legal entities are the main booking entities for covered trading activities of the trading desk;
- For each legal entity that serves as a booking entity for covered trading activities, specification of any of the following applicable entity types for that legal entity:
  - o National bank, Federal branch or Federal agency of a foreign bank, Federal savings association, Federal savings bank;
  - o State nonmember bank, foreign bank having an insured branch, State savings association;
  - o U.S.-registered broker-dealer, U.S.-registered security-based swap dealer, U.S.- registered major security-based swap participant;
  - o Swap dealer, major swap participant, derivatives clearing organization, futures commission merchant, commodity pool operator, commodity trading advisor, introducing broker, floor trader, retail foreign exchange dealer;
  - o State member bank;
  - o Bank holding company, savings and loan holding company;
  - o Foreign banking organization as defined in 12 CFR 211.21(o);
  - o Uninsured State-licensed branch or agency of a foreign bank; or
  - o Other entity type not listed above, including a subsidiary of a legal entity described above where the subsidiary itself is not an entity type listed above;
- Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and
- Currency reported and daily currency conversion rate.'

c. ***Quantitative Measurements Identifying Information***

Each banking entity must provide the following information regarding the quantitative measurements:

- A Risk and Position Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit;

- A Risk Factor Sensitivities Information Schedule that provides identifying and descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement, including the name of the sensitivity, a unique identification label for the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit;
- A Risk Factor Attribution Information Schedule that provides identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement, including the name of the risk factor or other factor, a unique identification label for the risk factor or other factor, a description of the risk factor or other factor, and the risk factor or other factor's change unit;
- A Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule; and
- A Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

~~b.~~d. ***Narrative Statement***

Each banking entity made subject to this appendix by § __.20 must submit in a separate electronic document a Narrative Statement to the [Agency] describing any changes in calculation methods used, a description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement must include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used.

If a banking entity does not have any information to report in a Narrative Statement, the banking entity must submit an electronic document stating that it does not have any information to report in a Narrative Statement.

~~c.~~e. ~~**B.**~~ ***Frequency and Method of Required Calculation and Reporting***

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report the Narrative Statement, the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the [Agency] on the reporting schedule established in § __.20 unless otherwise requested by the [Agency]. A banking entity must ~~be reported within the time period required by §.20~~report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the [Agency] in accordance with the XML Schema specified and published on the [Agency]'s website.

f. ~~**C.**~~ ***Recordkeeping***

A banking entity must, for any quantitative measurement furnished to the ~~Board~~[Agency] pursuant to this appendix and § __.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the [Agency] to verify the accuracy of such reports, for a period of ~~5~~five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the

Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the [Agency].

IV. Quantitative Measurements

a. ~~**A.**~~ ***Risk-Management Measurements***

1. Risk and Position Limits and Usage

i. *Description*: For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the ~~portion~~value of the trading ~~desk's limits~~desk's risk or positions that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited~~,~~ to, the limits set out in § .4 and § __.5. A number of the metrics that are described below, including "Risk Factor Sensitivities" and "Value-at-Risk ~~and Stress Value-at-Risk~~," relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market making activities under § __.4(b) and hedging activity under § __.5. Accordingly, the limits required under § __.4(b)(2)(iii) and § __.5(b)(1)(i)(A) must meet the applicable requirements under § __.4(b)(2)(iii) and § __.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, the "Risk Factor Sensitivities" and "Value-at-Risk ~~and Stress Value-at-Risk~~" metrics except to the extent any of the "Risk Factor Sensitivities" or "~~Value-at-Risk and Stress~~ Value-at-Risk" metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

~~General Calculation Guidance: Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached must be reported.~~

A. A banking entity must provide the following information for each limit reported pursuant to this quantitative measurement: the unique identification label for the limit reported in the Risk and Position Limits Information Schedule, the limit size (distinguishing between an upper and a lower limit), and the value of usage of the limit.

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

2. Risk Factor Sensitivities

i. *Description*: For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk. A banking entity must report the risk factor sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. Reported risk factor sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings. A banking entity must provide the

following information for each sensitivity that is reported pursuant to this quantitative measurement: the unique identification label for the risk factor sensitivity listed in the Risk Factor Sensitivities Information Schedule, the change in risk factor used to determine the risk factor sensitivity, and the aggregate change in value across all positions of the desk given the change in risk factor.

~~General Calculation Guidance: A banking entity must report the risk factor sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. The underlying data and methods used to compute a trading desk's Risk Factor Sensitivities will depend on the specific function of the trading desk and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading desk, and furnished to the Board, will depend on the explicit risks assumed by the trading desk. In general, however, Reported risk factor sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings.~~

~~Trading desks must take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:~~

~~• Commodity derivative positions: risk factors with respect to the related commodities set out in 17 CFR 20.2, the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;~~

~~• Credit positions: risk factors with respect to credit spreads that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and risk factors with respect to interest rates of all relevant maturities;~~

~~• Credit-related derivative positions: risk factor sensitivities, for example credit spreads, shifts (parallel and non-parallel) in credit spreads—volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;~~

~~• Equity derivative positions: risk factor sensitivities such as equity positions, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;~~

~~• Equity positions: risk factors for equity prices and risk factors that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;~~

~~• Foreign exchange derivative positions: risk factors with respect to major currency pairs and maturities, exposure to interest rates at relevant maturities, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and~~

~~• Interest rate positions, including interest rate derivative positions: risk factors with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and shifts (parallel and non-parallel) in the interest rate curve, as well as the maturity profile of the positions.~~

~~The methods used by a banking entity to calculate sensitivities to a common factor shared by multiple trading desks, such as an equity price factor, must be applied consistently across its trading desks so that the sensitivities can be compared from one trading desk to another.~~

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

3. Value-at-Risk and ~~Stress~~Stressed Value-at-Risk

i. *Description*: For purposes of this appendix, Value-at-Risk ("VaR") is the ~~commonly used percentile~~ measurement of the risk of future financial loss in the value of a ~~given set of~~trading desk's aggregated positions at the ninety-nine percent confidence level over a ~~specified~~one-day period ~~of time~~, based on current market conditions. For purposes of this appendix, ~~Stress~~Stressed Value-at-Risk ("~~Stress~~Stressed VaR") is the ~~percentile~~ measurement of the risk of future financial loss in the value of a ~~given set of~~trading desk's aggregated positions at the ninety-nine percent confidence level over a ~~specified~~one-day period ~~of time~~, based on market conditions during a period of significant financial stress.

~~General Calculation Guidance: Banking entities must compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading desk that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR must be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions.~~

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: For VaR, all trading desks engaged in covered trading activities. For Stressed VaR, all trading desks engaged in covered trading activities, except trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument" under § __.3(d)(2).

b. ***Source-of-Revenue Measurements***

1. Comprehensive Profit and Loss Attribution

i. *Description*: For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's ~~comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (i.e., the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule~~comprehensive profit and loss at each point in time.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day.

The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. For the attribution of comprehensive profit and loss from existing positions to specific risk factors and other factors, a banking entity must provide the following information for the factors that explain the preponderance of the profit or loss changes due to risk factor changes: the unique identification label for the risk factor or other factor listed in the Risk Factor Attribution Information Schedule, and the profit or loss due to the risk factor or other factor change.

C. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

D. The portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

~~ii. *General Calculation Guidance:* The specific categories used by a trading desk in the attribution analysis and amount of detail for the analysis should be tailored to the type and amount of trading activities undertaken by the trading desk. The new position attribution must be computed by calculating the difference between the prices at which instruments were bought and/or sold and the prices at which those instruments are marked to market at the close of business on that day multiplied by the notional or principal amount of each purchase or sale. Any fees, commissions, or other payments received (paid) that are associated with transactions executed on that day must be added (subtracted) from such difference. These factors must be measured consistently over time to facilitate historical comparisons.~~

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

c. *Positions, Transaction Volumes, and Securities Inventory Aging Measurements*

1. Positions

i. *Description*: For purposes of this appendix, Positions is the value of securities and derivatives positions managed by the trading desk. For purposes of the Positions quantitative measurement, do not include in the Positions calculation for "securities" those

securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[FN 283] A banking entity must separately report the trading desk's market value of long securities positions, market value of short securities positions, market value of derivatives receivables, market value of derivatives payables, notional value of derivatives receivables, and notional value of derivatives payables.

[FN 283: See §§ __.2(i), (bb). For example, under this part, a security-based swap is both a "security" and a "derivative." For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.]

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks that rely on § __.4(a) or § __.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description*: For purposes of this appendix, Transaction Volumes measures four exclusive categories of covered trading activity conducted by a trading desk. A banking entity is required to report the value and number of security and derivative transactions conducted by the trading desk with: (i) customers, excluding internal transactions; (ii) non-customers, excluding internal transactions; (iii) trading desks and other organizational units where the transaction is booked in the same banking entity; and (iv) trading desks and other organizational units where the transaction is booked into an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[FN 284] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § .4(a) to conduct underwriting activity is a market participant identified in § __.4(a)(7), and a customer of a trading desk that relies on § __.4(b) to conduct market making-related activity is a market participant identified in § __.4(b)(3).

[FN 284: See §§ __.2(i), (bb).]

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks that rely on § __.4(a) or § __.4(b) to conduct underwriting activity or market-making-related activity, respectively.

~~**C. Customer-Facing Activity Measurements**~~

~~**1. Inventory Turnover**~~

~~i. *Description:* For purposes of this appendix, Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period.~~

~~ii. General Calculation Guidance: For purposes of this appendix, for derivatives, other than options and interest rate derivatives, value means gross notional value,~~

for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. Calculation Period: 30 days, 60 days, and 90 days.

iv. *Measurement Frequency*: Daily.

2. Inventory Aging

3. Securities Inventory Aging

i. *Description*: For purposes of this appendix, Securities i. Description: For purposes of this appendix, Inventory Aging generally describes a schedule of the market value of the trading desk's aggregate assets and liabilitiesdesk's securities positions and the amount of time that those assets and liabilitiessecurities positions have been held. Securities Inventory Aging shouldmust measure the age profile of the trading desk's assets and liabilities. securities positions for the following periods: 0-30 calendar days; 31- 60 calendar days; 61-90 calendar days; 91-180 calendar days; 181-360 calendar days; and greater than 360 calendar days. Securities Inventory Aging includes two schedules, a security asset- aging schedule, and a security liability-aging schedule. For purposes of the Securities Inventory Aging quantitative measurement, do not include securities that are also "derivatives," as those terms are defined under subpart A. [FN 285]

[FN 285: See §§ __.2(i), (bb).]

General Calculation Guidance: In general, Inventory Aging must be computed using a trading desk's trading activity data and must identify the value of a trading desk's aggregate assets and liabilities. Inventory Aging must include two schedules, an asset- aging schedule and a liability-aging schedule. Each schedule must record the value of assets or liabilities held over all holding periods. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value and, for interest rate derivatives, value means 10-year bond equivalent value.

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks that rely on § .4(a) or § .4(b) to conduct underwriting activity or market-making related activity, respectively. **3. Customer-Facing Trade Ratio—Trade Count Based and Value Based**

i. *Description:* For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A trade count based ratio must be computed that records the number of transactions involving a counterparty that is a customer of the trading desk and the number of transactions involving a counterparty that is not a customer of the trading desk. A value based ratio must be computed that records the value of transactions involving a counterparty that is a customer of the trading desk and the value of transactions involving a counterparty that is not a customer of the trading desk.

ii. *General Calculation Guidance:* For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other

organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of $50 billion or more as measured in accordance with §20(d)(1) unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

Appendix B to Part—Enhanced Minimum Standards for Compliance Programs

[*N.B.: Appendix B to the 2013 Rule is omitted in its entirety from the Proposed Rule.*]