SULLIVAN & CROMWELL LLP

December 13, 2013

Volcker Rule

Agencies Approve Long-Awaited Final Rule; Most Requirements to Take Effect on July 21, 2015

SUMMARY

On December 10, 2013, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation (the "FDIC"), Securities and Exchange Commission (the "SEC") and Commodity Futures Trading Commission (together, the "Agencies") approved a final rule (the "Final Rule") implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commonly referred to as the "Volcker Rule."

In connection with the Final Rule, the Federal Reserve exercised its independent authority to grant a blanket one-year extension of the Volcker Rule conformance period for all banking organizations. As a result, banking organizations will have until July 21, 2015 to comply fully with most requirements of the Final Rule. An important exception applies for banking organizations with significant trading activities, which will be required to report quantitative metrics on their trading activities beginning in July 2014. The extension also requires banking organizations to use good faith efforts during the conformance period to conform to the Final Rule and promptly cease any "stand-alone" proprietary trading.

The Volcker Rule—one of the centerpieces of financial reform under the Dodd-Frank Act—imposes broad restrictions on proprietary trading and investing in and sponsoring private equity and hedge funds by banking organizations and their affiliates. The long-awaited Final Rule follows a period of unusually public interagency debate over its final terms. The Final Rule itself is 71 pages, and the detailed "Supplementary Information," which is critical to understanding and interpreting the Final Rule, is nearly 900 pages and includes more than 2,800 footnotes.

In general, although many of the most unclear or troublesome provisions of the proposed rule have been addressed, the Final Rule remains a sweeping regulation, with broad extraterritorial application, that will fundamentally shape how banking organizations do business. Many of its effects may become apparent only over several years as the Agencies apply the Volcker Rule in practice.

The table attached to this memorandum as ***Annex A*** provides an initial overview of certain key requirements of the Final Rule and highlights certain changes in these requirements from the Agencies' October 11, 2011 notice of proposed rulemaking.[1]

In the coming weeks, Sullivan & Cromwell LLP expects to publish a more detailed memorandum summarizing and analyzing the Final Rule. In addition, Sullivan & Cromwell LLP will be co-hosting web-based presentations with Promontory Financial Group on the Final Rule on December 16, 2013 and January 15, 2014. For more information, please contact Nathalie-Claire Chiavaroli (+1-212-558-3976; chiavarolin@sullcrom.com).

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[1] Please see our Memorandum to Clients, dated October 12, 2011, "Agencies Release Proposed Rule Implementing the Volcker Rule," for a detailed discussion of the proposed rule.

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Volcker Rule: Overview of Key Requirements of the Final Rule and Key Changes from the Proposed Rule

The following table provides an overview of key requirements of the Final Rule, including relevant commentary from the Agencies in the Supplementary Information. The table also summarizes the corresponding requirements under the proposed rule and highlights key changes, if any, between the proposed rule and the Final Rule.

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Topic	Requirement under Proposed Rule	Requirement under Final Rule
A. Coverage, Timing and Regulatory Coordination		
1. To which entities does the Volcker Rule apply?	The proposed rule would apply to "banking entities," defined broadly to include: • any insured depository institution and any company that controls an insured depository institution, such as a bank holding company or a savings and loan holding company; • a foreign bank that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978 (i.e., because it has a U.S. branch or agency); and • any affiliate or subsidiary of the foregoing (as defined in the Bank Holding Company Act of 1956 (the "BHC Act")). Under this definition, "affiliate" or "subsidiary" could have included certain "covered funds" in which banking entities were permitted to hold interests, meaning that they would themselves become subject to the restrictions of the Volcker Rule.	The Final Rule includes a substantially similar definition of "banking entities" to which the Volcker Rule will apply, but specifically excludes: • a covered fund; • a portfolio company held under merchant banking authority; and • a "portfolio concern" controlled by a small business investment company ("SBIC"); provided that, in each case, the entity is not itself an insured depository institution or a foreign bank or a company controlling either. The Final Rule continues to incorporate the BHC Act's definitions of "affiliate" and "subsidiary."
2. When does it apply?	Banking entities' activities and investments would have to be conformed by July 21, 2014. The Dodd-Frank Act provides the Federal Reserve sole authority to grant extensions to the conformance period. Under the Federal Reserve's final conformance rule issued in 2011, banking entities could apply for up to three one-year extensions to the conformance period (in other words, through July 2017 at the latest) and an additional five-year extended conformance period for "illiquid funds" (but defined very narrowly to exclude many funds commonly thought of as "illiquid").	The Federal Reserve issued an order automatically providing the first of the three one-year extensions, through July 2015, to all banking entities. Banking entities are not required to submit an application or a conformance plan. The extension does not apply to the quantitative trading metric reporting requirements that apply to banking entities with significant trading activities. During the conformance period, banking entities are generally expected to engage in good-faith efforts to conform their activities and investments, and banking entities that have "stand-alone proprietary trading operations" are expected to promptly terminate or divest those operations.
3. Who will apply it, and how will regulators coordinate?	Multiple regulators could be responsible for supervising, examining and enforcing the Volcker Rule with respect to a banking entity, its subsidiaries and affiliates or even its trading desks. As one of many examples, a broker-dealer subsidiary	The Supplementary Information notes that the Agencies have declined to adopt a provision whereby a single Agency would be responsible for determining Volcker Rule compliance. The Agencies intend to "coordinate their examination and

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	of a bank holding company could be subject to supervision both by the SEC and by the Federal Reserve as the prudential supervisor of the bank holding company's operations.	enforcement proceedings [under the Volcker Rule] to the extent possible and practicable."
B. Proprietary Trading		
4. What is "proprietary trading" under the Volcker Rule?	Banking entities may not engage in "proprietary trading" unless an exemption is available. Under the proposed rule, "proprietary trading" would generally include taking principal positions in securities, options, swaps, futures or other derivatives: • with short-term trading intent (the "Purpose Test"); • where the positions are covered by the market risk capital rule (the "Market Risk Capital Rule Test"); or • where the positions are held by a registered dealer, if taken in connection with dealer activities requiring registration (the "Status Test"). Holding a position for 60 days or less would confer a rebuttable presumption of short-term intent under the Purpose Test.	The Final Rule maintains essentially the same definition of "proprietary trading." Commenters had generally focused on whether the three tests served as effective proxies for true proprietary trading intent (and whether, to the extent effective, they were duplicative). In adopting the Final Rule, the Agencies described the three tests as "mutually reinforcing," stating with respect to the Status Test in particular that "dealer activity generally involves short-term trading." Furthermore, in response to comments that the rebuttable presumption should work both ways, the Agencies expressly declined to establish a safe harbor or reverse presumption for positions held for 60 days or more.
5. What is **not** proprietary trading?	The proposed rule provided that the following positions or transactions would generally **not** be considered proprietary trading: • spot foreign exchange and spot physical commodities; • loans; • repo and reverse repo and securities lending; • certain clearing-related positions of registered derivatives clearing organizations; or • "for the bona fide purpose of liquidity management" (see below).	The Final Rule carries forward these exclusions from the definition of proprietary trading and provides further exclusions for a broader range of clearing-related activities by derivatives clearing organizations and clearing agencies and clearinghouse members, as well as transactions in connection with failures to deliver, judicial or similar proceedings, agent, brokerage or custodial activities, certain employee compensation plans and debts previously contracted. The Final Rule also provides that a "loan" does not include a security or derivative.

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Exclusion for "liquidity management"	The proposed rule provided an exclusion for positions taken for bona fide liquidity management purposes in accordance with a documented liquidity management plan that meets the following requirements, among others: • the plan authorizes particular instruments to be used; • the plan requires that any position be highly liquid and limited to instruments not expected to give rise to appreciable profits or losses in the short term; and • the plan limits any positions taken to an amount consistent with the banking entity's "near-term funding needs."	This exclusion is highly relevant to many banking entities without significant trading activities whose liquidity management activities, while not "proprietary trading" as commonly understood, could nonetheless be restricted by the Volcker Rule. The Final Rule narrowed the exclusion by limiting the permissible instruments to securities (in other words, not swaps, commodities or futures) and requiring that the liquidity management plan include controls, analysis and testing. The Agencies declined to broaden the exclusion to cover asset-liability management generally and stated that the exclusion does not apply to "hedging aggregate risks . . . related to asset-liability mismatches." Banking entities may attempt to rely on the exemption for risk-mitigating hedging for asset-liability management, though that exemption also has many specific requirements (see below).
6. What activities **are** proprietary trading, but may be **permitted**?	Some proprietary trading is permissible under one or more exemptions provided under the Dodd-Frank Act. Under the proposed rule, permitted activities and compliance would have been assessed for each "trading unit," generally defined as "individual trading desks, intermediate divisions that oversee a variety of trading desks, and all trading operations in the aggregate."	The Final Rule includes the proposed rule's exemptions, in many cases streamlining the rule text while preserving similar underlying requirements. The extent of the compliance and recordkeeping regime that will be required in connection with permitted activities remains considerable (see below). The Final Rule replaces the concept of "trading unit" with "trading desk." While this prevents the need to calculate quantitative trading metrics at multiple overlapping levels, it confirms that banking entities will be required to perform analyses at the "trading desk" level and will generally not be able to do so only in the aggregate for trading divisions or operations. On the other hand, "trading desk" is defined by function and can span legal entities, which provides flexibility.
Underwriting activities	The Dodd-Frank Act permits banking entities to engage in "underwriting . . . designed not to exceed the reasonably expected near term demands of clients, customers or counterparties." The proposed rule included an exemption that covered core aspects of directly underwriting large offerings of securities, but cast doubt on the ability to participate in smaller offerings,	The underwriting exemption in the Final Rule is broader and has been clarified in places. This reflects the Agencies' view that underwriting activities are generally beneficial and relatively unlikely to be used as a disguise for prohibited proprietary trading. The definition of an exempted underwriting now more clearly includes private placements and commercial paper issuances.

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	to engage in price stabilization or other syndicate activities in connection with an underwriting or to hold an unsold allotment from an underwriting.	All offerings registered under the Securities Act qualify. The exemption now also extends to underwriting-related activities such as syndicate aftermarket short covering. Finally, the Final Rule clarifies that holding an unsold allotment will not preclude reliance on the underwriting exemption, provided that "reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period."
Market making-related activities	The Dodd-Frank Act permits banking entities to engage in "market making-related activities . . . designed not to exceed the reasonably expected near term demands of clients, customers or counterparties." Distinguishing between permitted market making-related activities and prohibited proprietary trading is one of the most difficult challenges associated with the Volcker Rule. The proposed rule would have required that each trade by a market making desk not only satisfy numerous specific criteria, but also be "consistent" with extensive narrative commentary on the nature of market making. Although the proposed rule did state clearly that the Agencies appreciated the varied nature of market making-related activities, especially in illiquid markets, banking entities expressed widespread concerns that the proposed rule would chill market making and reduce the provision of liquidity in worldwide financial markets.	The Agencies determined that "certain modifications are warranted [in the Final Rule] . . . to prevent a potential chilling effect on market making-related activities." In lieu of more numerous criteria in the proposed rule, the Final Rule now generally requires that a market making trading desk "routinely stand[] ready to purchase and sell . . . and [be] willing and available to quote . . . in commercially reasonable amounts and throughout market cycles." In addition, the Final Rule now focuses on a trading desk's "financial exposure," rather than on whether each individual trade can be determined to have a market-making character. Trading desks may maintain "market-maker inventories" of proprietary positions, but inventories must be based on "demonstrable analysis of historical customer demand." With respect to interdealer trading, the Agencies stated that they "recognize that . . . interdealer trading provides certain market benefits," such as "more efficient matching of customer order flow," and "greater hedging options to reduce risks." Except in limited circumstances, however, other large dealers may not themselves be viewed as customers. Furthermore, the Agencies noted that interdealer trading is "an activity that will bear some scrutiny by the Agencies." The Supplementary Information provides that banking entities should generally be able to rely on this exemption for primary dealer activities and activities as an authorized participant in ETFs.

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Risk-mitigating hedging	The Dodd-Frank Act permits banking entities to engage in "[r]isk-mitigating hedging activities in connection with and related to individual or aggregated positions . . . that are designed to reduce the specific risks" of such positions. The proposed rule included a hedging exemption with several requirements, including that the hedging activity be (and remain) "reasonably correlated" to the risks hedged and introduce no new risks that were not present in the original position. The proposed rule stated that "portfolio hedging" would be possible.	The Final Rule limits the availability of the hedging exemption and imposes more stringent compliance, testing and monitoring requirements. Hedging is permitted if it reduces "specific, *identifiable* risks" and does not simultaneously create significant new risks, but requires "ongoing recalibration" and extensive documentation. The Final Rule does not prohibit anticipatory hedging to the extent consistent with the requirements of the exemption. Like the Dodd-Frank Act itself, the Final Rule permits hedging of "aggregated positions." Market making trading desks that hedge their own risks (as opposed to having them hedged by separate trading desks or departments) are subject to a simplified set of requirements tied to the desk's own risk-management policies and procedures.
Trading in U.S. government obligations	The proposed rule provided an exemption, derived from the statute, for trading in obligations of the United States and U.S. agencies, states and political subdivisions, as well as instruments issued by Fannie Mae, Freddie Mac and similar government-sponsored enterprises ("GSEs"). There was no exemption for derivatives on these instruments, however, even though many banking entities trade in such derivatives in connection with underlying primary dealer responsibilities.	The Final Rule expanded the exemption to include obligations *guaranteed* by (in addition to obligations *issued* by) the United States or an agency thereof, including pass-through or participation certificates issued or guaranteed by GSEs, and municipal securities (as defined for purposes of the Securities Exchange Act of 1934 (the "Exchange Act")). The Agencies declined to add an exemption for trading in derivatives on U.S. government obligations, stating that such trading, including in connection with primary dealer activities, may be able to qualify for the market making-related activities exemption or risk-mitigating hedging exemption.
Trading in non-U.S. government obligations	The proposed rule contained no categorical exemption for trading in any non-U.S. government obligations. While such trading might have been able to qualify for one or more other exemptions (such as market making or liquidity management), this might not have been true in all cases.	The Final Rule includes narrow exemptions for trading in non-U.S. government obligations, including obligations of multinational central banks, in the following cases: • ***U.S. affiliates of foreign banking entities (and potentially foreign banking entities themselves and their non-U.S. affiliates)*** that are not insured depository institutions may trade sovereign (and multinational central bank) obligations of the foreign banking entity's home jurisdiction; and

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		• ***foreign bank or securities dealer subsidiaries (but not branches) of a U.S. banking entity*** may trade sovereign (and multinational central bank) obligations of the home jurisdiction country so long as the transaction is not financed by a U.S. affiliate or an affiliate located in the United States. The Final Rule does not provide guidance as to how to ensure and document compliance with the financing requirement.
Trading by a regulated insurance company	The proposed rule provided an exemption for positions taken for the general account of a regulated insurance company, provided that the positions are in compliance with and subject to insurance company investment laws and guidance of the insurance company's home jurisdiction. The proposed rule also provided an exemption for separate insurance accounts under the "on behalf of customers" exemption (see below).	The Final Rule combines the proposed exemptions for regulated insurance companies' general accounts and separate accounts.
Trading on behalf of customers	The proposed rule provided an exemption for positions taken on behalf of customers in a fiduciary capacity, positions taken as a "riskless principal" and positions taken in connection with an insurance company separate account.	The Final Rule retains these exemptions, combining the insurance company exemptions as noted above.
Activities of foreign banking entities outside the United States	The proposed rule provided an exemption for trading "solely outside the United States." This exemption would be available only if: • the banking entity is neither organized under U.S. law nor controlled by a banking entity organized under U.S. law; • no party to the transaction is a U.S. resident; • no banking entity personnel who are directly involved in the transaction are physically located in the United States; and • the transaction is executed wholly outside the United States. The availability of this exemption would have been limited as a result of the significant global role that U.S. exchanges and trading platforms play in the execution of transactions.	The Final Rule shifts the focus of this exemption from the location of trade execution to the location and identities of the parties buying and selling risk. Specifically, a foreign banking organization can effect: • a transaction with the foreign operations of a U.S. entity if no personnel of the U.S. entity located in the United States are involved in the arrangement, negotiation, or execution of the transaction; • a transaction with an unaffiliated U.S. broker, dealer or futures commission merchant ("FCM") acting as principal, provided that the transaction is promptly cleared and settled through a central counterparty; and • a transaction through an unaffiliated U.S. broker, dealer or FCM acting as agent, provided that the transaction is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled

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		through a central counterparty. In each case, to qualify for this exemption, the transaction may not be (i) arranged, negotiated or executed by personnel located in the United States or (ii) financed directly or indirectly by a U.S. branch or affiliate.
C. "Covered Fund" Activities and Investments		
7. What "covered funds" are covered by the prohibition?	Banking entities generally may not acquire or retain an ownership interest in, or sponsor, a "covered fund." The proposed rule defined "covered fund" broadly to include: • any issuer that relies on Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the "1940 Act"); • a commodity pool (i.e., an enterprise operated for the purpose of trading in commodity interests); and • certain foreign funds. Although the proposed definition of "covered fund" would cover many hedge funds and private equity funds, it also captured a wide variety of entities without the characteristics traditionally associated with those types of funds. For example, many wholly owned subsidiaries and joint ventures would have been "covered funds" under the proposed definition. A key difficulty arose from the fact that while the proposed rule provided that a banking entity could own interests in or sponsor certain **permitted** covered funds, it imposed strict prohibitions on certain important relationships and transactions with **any** covered fund. These relationship limitations are referred to as "Super 23A" (see below).	The approach taken by the Agencies in the Final Rule is to maintain a substantially similar (broad) definition of "covered fund," but to include a significant number of exclusions from the definition (see below). This means that not only are these excluded funds not covered by the Volcker Rule prohibitions on ownership or sponsorship, but they are also not subject to Super 23A. The Agencies declined to adopt a characteristics-based definition of covered fund based on criteria such as investments or investors that are typically associated with hedge funds or private equity funds. The Agencies also specifically declined to provide exclusions or exemptions for financial market utilities, cash collateral pools, pass-through REITS, municipal securities tender option bond transactions, venture capital funds, CDOs, credit funds or employee securities companies, but noted that other exclusions or exemptions provided in the Final Rule (or that are otherwise available under the 1940 Act) may be available for some or all of these entities.

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8. What entities are **<u>not</u>** covered funds?	The proposed rule generally covered all entities captured by the definition of "covered fund" described above.	The most notable new exclusions from the definition of covered fund are summarized below. Exclusions were also adopted for the following types of entities (not described in detail in this chart): foreign pension or retirement funds; bank owned life insurance; qualifying asset-backed commercial paper conduits; qualifying covered bond pools; SBICs and public welfare investments; registered investment companies; business development companies; and issuers formed by the FDIC in conjunction with receivership or conservatorship operations. The Final Rule also clarified that entities that can rely on exemptions **<u>other</u>** **<u>than</u>** Section 3(c)(1) or 3(c)(7) of the 1940 Act, such as a real estate fund that relies on Section 3(c)(5)(C), are not covered funds, even if they may **<u>also</u>** rely on Section 3(c)(1) or 3(c)(7).
Certain commodity pools	As noted above, the proposed rule included as a covered fund any "commodity pool," as defined in Section 1a(10) of the Commodity Exchange Act.	The Final Rule significantly limits the scope of commodity pools that are covered funds, including only commodity pools for which: • the commodity pool operator ("CPO") has claimed an exemption under 17 CFR § 4.7 (e.g., a CPO that offers or sells participations in a commodity pool solely to qualified eligible persons in an exempt offering); or • (i) the CPO is registered with the CFTC as a CPO in connection with the commodity pool; (ii) substantially all participation units of the commodity pool are owned by qualified eligible persons; and (iii) participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons. The Supplementary Information notes that this more tailored approach, together with the exclusions from the definition of "covered fund," is designed to more accurately identify those commodity pools that are similar to issuers that would be investment companies but for Section 3(c)(1) or 3(c)(7).

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"Foreign funds" generally	The proposed rule included as a covered fund any "issuer," as defined in Section 2(a)(22) of the 1940 Act, that is organized or offered outside the United States but would be a covered fund were it organized or offered under the laws of, or offered to one or more residents of, the United States.	The Final Rule introduces the concept of funds that are organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States ("foreign funds"). A foreign fund would generally be a "covered fund" for a U.S. banking entity that sponsors it or has an ownership interest in it, but would **not** be a "covered fund" for a **foreign bank** that invests in the fund solely outside the United States.
Foreign "public" funds	The proposed rule's broad inclusion of foreign funds would have extended to "retail" funds that are publicly offered in non-U.S. jurisdictions ("foreign public funds").	The Final Rule excludes from the definition of covered fund any foreign public fund that: • is organized or established outside the United States; • is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and • sells ownership interests predominantly through one or more public offerings outside the United States, where (i) the offering must include public offering documents, (ii) the offering must **not** include investor net worth tests, (iii) "predominantly" generally means that at least 85% of the fund's interests are sold to non-U.S. residents and (iv) for U.S. banking entities relying on the exception, ownership interests are sold "predominantly" to persons other than affiliated entities and persons. The Supplemental Information notes that the foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of the Volcker Rule, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside the United States.
Wholly owned subsidiaries, joint ventures and acquisition vehicles	The proposed rule provided exemptions for wholly owned subsidiaries, joint ventures and acquisition vehicles, but these were of limited utility because of the conditions to be met, and the vast majority of these entities were still technically "covered funds" and therefore subject to Super 23A.	The Final Rule excludes the following entities from the definition of covered fund, provided that they satisfy the conditions indicated. Entities that fit within these exclusions from the definition of covered fund are not subject to Super 23A. • ***Wholly owned subsidiaries:*** Without compromising this

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		exemption, up to 0.5% of a subsidiary's ownership interests may be held by a third party for purposes of establishing corporate separateness or addressing bankruptcy concerns, and up to 5% (less amounts held by a third party) may be held by employees or directors of the banking entity. • ***Joint ventures:*** These must: (i) include no more than 10 unaffiliated co-venturers; (ii) be engaged in activities permissible for a banking entity (other than investing in securities for resale); and (iii) not hold themselves out as entities that raise money from investors primarily for the purpose of investing in securities for resale. The third condition has the effect of precluding a joint venture engaged in merchant banking activities from relying on the exclusion. • ***Acquisition vehicles:*** These must be formed solely for engaging in a bona fide merger or acquisition transaction and exist only for the period necessary to do so.
Loan securitizations	The proposed rule included an exemption for issuers of asset-backed securities the assets or holdings of which are composed solely of loans and related assets. As with wholly owned subsidiaries, these issuers would have remained "covered funds" and therefore subject to Super 23A. It was not clear under the proposed rule whether entities that invest predominantly in loans with a long-term investment objective would have fallen within the exemption for issuers of asset-backed securities.	The Final Rule provides an exclusion from the definition of "covered fund" for certain loan securitizations. The exclusion covers issuers of asset-backed securities, as defined in Section 3(a)(79) of the Exchange Act, the underlying assets or holdings of which are exclusively composed of: • loans (which, under the Final Rule, do not include any securities or derivatives); • any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders or related or incidental to purchasing or otherwise acquiring and holding the loans; • certain interest rate or foreign exchange derivatives; and • certain special units of beneficial interests and collateral certificates. An eligible loan securitization may not hold any securities, including asset-backed securities (other than certain cash equivalents and securities received in lieu of debts previously

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		contracted with respect to the loans supporting the asset-backed securities), other types of derivatives or commodity forward contracts. The Agencies did not provide a separate exclusion for CDOs and other securitization pools holding securities.
Insurance company separate accounts	Insurance company separate accounts would have been covered funds to the extent that they relied on Section 3(c)(1) or 3(c)(7) (e.g., where policies funded by the separate account were distributed in an unregistered securities offering solely to qualified purchasers or on a limited basis to accredited investors).	To accommodate the business of insurance in a regulated insurance company, the Final Rule excludes an insurance company separate account from the definition of covered fund, provided that no banking entity other than the insurance company that establishes the separate account participates in the account's profits and losses.
9. Under what conditions may a banking entity "organize and offer" or "sponsor" a covered fund?	Under the proposed rule, a banking entity could organize and offer a covered fund, including generally acting as a "sponsor" of the fund, if several statutory conditions were met. The proposed rule defined "sponsor" to mean: • to serve as a general partner, managing member, trustee, or commodity pool operator of a covered fund; • 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 • to share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.	The Final Rule maintains an exemption for organized and offered funds that largely tracks the language of the Dodd-Frank Act, and adopts a substantially similar definition of "sponsor," with certain modifications and clarifications to exclude "directed trustees." The Supplementary Information also notes that a banking entity that selects the initial directors, trustees, or management of a fund would not be considered to be a sponsor once that control terminates (including upon re-election of the directors by a board of directors that is self-perpetuating or selected by the fund's shareholders). The Final Rule also includes a separate exemption for organizing and offering an issuer of asset-backed securities.
Requirements	The proposed rule permitted the organizing and offering of a covered fund only if the following conditions were met: • the banking entity (or any affiliate) provides bona fide trust, fiduciary or investment advisory services; • the fund is organized and offered in connection with the provision of bona fide trust, fiduciary or investment advisory services to customers; • the banking entity and its affiliates comply with the	The Final Rule adopts the criteria for permitted organizing and offering substantially as proposed. The Supplementary Information clarifies the scope of the criteria in certain respects, including the following: • a banking entity is not prohibited from providing borrower default indemnification to lending clients in connection with securities lending transactions; and • employees of a banking entity may invest in the covered fund if they provide services that enable the provision of

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	Volcker Rule's ownership limits and with Super 23A and do not guarantee the obligations or performance of the covered fund; • the covered fund does not share a name with the banking entity (or any affiliate) or have the word "bank" in its name; • no director or employee of the banking entity (or any affiliate) has an ownership interest in the covered fund unless engaged in providing investment advisory or other services to the covered fund; and • the banking entity provides specific disclosures to investors in the covered fund.	investment advice or investment management, such as oversight and risk management, deal origination, due diligence, administrative or other support services. A covered fund that is an issuer of asset-backed securities need not be organized and offered in connection with a banking entity's provision of bona fide trust, fiduciary or investment advisory services to customers.
Calculation of ownership limits and capital deductions	A banking entity's ownership interest in covered funds that it organizes and offers was limited to: • 3% of the total outstanding ownership interests of any individual fund at any time more than one year after the date of its establishment; and • with respect to the aggregate value of all ownership interests in such covered funds, 3% of the banking entity's Tier 1 capital. A banking entity was required to deduct such aggregate value from its calculation of regulatory capital. The proposed rule also attributed to a banking entity: • any ownership interest in a covered fund held by any entity controlled by the banking entity and any parallel investment arising out of a contractual obligation or knowing participation in a common plan to invest; and • a pro rata share of any ownership interest held by any non-controlled covered fund in which the banking entity owns, controls or holds with the power to vote more than 5% of the voting shares. The proposed rule provided that a banking entity must comply with both measures of the per-fund limitation at all times. The preamble to the proposal explained that the Agencies	The Final Rule includes the same limitations on ownership interest in an organized and offered covered fund and cap on aggregate value, but clarifies the calculation methodologies as described below. In addition, it permits a banking entity to acquire the amount of interest, typically 5%, in an issuer of asset-backed securities that is required by the risk retention rules under Section 15G of the Exchange Act. • ***Seeding:*** The Final Rule maintains a one-year seeding period, but clarifies that the date from which the period runs is that date on which the fund begins making investments pursuant to the written investment strategy for the fund or, in the case of an issuer of asset-backed securities, the date on which the assets are initially transferred to the securitization. • ***Calculation***: The Final Rule modifies certain aspects of the calculation of the ownership interest, including specific rules for calculating master-feeder fund and fund-of-fund structures that excludes feeder funds and includes the pro rata share of any ownership of a fund held by a fund-of-funds. The aggregate investment limit is to be calculated based on acquisition cost of covered fund interests, rather than their value. The amount of the regulatory capital deduction is to be the greater of acquisition cost and fair market value of the covered fund

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	expected a banking entity to calculate its per-fund limitation no less frequently than the frequency with which the fund performs such calculation or issues or redeems interests and, in any case, at least quarterly.	interests. • ***Attribution:*** The Final Rule clarifies that covered funds, registered investment companies, SEC-regulated business development companies and foreign public funds will not be considered affiliates for purposes of attribution provided that certain conditions are met. Ownership interest of directors and employees would be attributed to the banking entity if the banking entity financed the purchase. Pro rata attribution of non-controlled investments is generally no longer required, except in the case of investments through a multi-tier fund structure. In addition, the Final Rule no longer includes attribution of parallel investments. The Supplementary Information notes, however, that a sponsoring banking entity should observe certain limits with respect to co-investments and other investing activity alongside a covered fund. • ***Timing:*** Under the Final Rule, calculations of ownership interest are required to be made quarterly on the basis of both the number and value of ownership interests. The Supplementary Information notes that banking entities are expected to take steps to ensure that the banking entity complies promptly with the per-fund limitations if it becomes aware that it has exceeded the limitation at any time.
10. What other activities are permitted?	The proposed rule provided a number of exemptions for covered fund activities and investments deemed to be permissible (e.g., investments in SBICs), many of which have become exclusions from the definition of “covered fund.”	Because the Final Rule provided exclusions from the definition of “covered fund” for many entities that were deemed permissible under the proposed rule, the Final Rule retains fewer exemptions. In addition to the exemptions for risk-mitigating hedging and covered fund ownership and sponsorship activities by foreign banking organizations occurring solely outside the United States (see below), the Final Rule permits insurance companies to acquire or retain an ownership interest in, or act as sponsor to, a covered fund for either the general account of the insurance company or one or more separate accounts established by the insurance company. The Final Rule also expands the statutory underwriting and market making-related

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		activities exemptions included in the proprietary trading prohibitions to covered fund activities.
Risk-mitigating hedging	The hedging exemption for covered fund activities under the proposed rule included many of the same requirements as the proprietary trading hedging exemption, but added a number of additional limiting criteria, including that a permitted hedge must mitigate an offsetting exposure, to the same covered fund and in the same amount, that either (i) arises out of a specific customer request or (ii) is directly connected to compensation of an employee who directly provides investment advisory or other services to the fund.	The hedging exemption for covered fund activities in the Final Rule has been further narrowed to apply only to the hedging of employee compensation, eliminating the ability for banking entities to engage in covered fund hedging arising out of a specific customer request. The Final Rule eliminates the requirement that the permitted hedge must mitigate an offsetting exposure in the same amount.
Covered fund activities and investments outside the United States	The proposed rule provided an exemption for covered fund ownership and sponsorship activities by foreign banking organizations occurring solely outside the United States that was substantially similar to the exemption for permitted trading solely outside the United States, and included a condition prohibiting offers and sales to U.S. residents.	The Final Rule maintains a similar exemption for ownership and sponsorship activities by foreign banking organizations solely outside the United States, but clarifies that an ownership interest in a covered fund is not "offered for sale or sold to a resident of the United States" if it is or has been sold pursuant to an offering that does not *target* residents of the United States. The Final Rule also clarifies that to qualify for this exemption, the banking entity (including relevant personnel) that makes the decision to acquire the ownership interest or act as sponsor must not be located in the United States. The exemption is not lost, however, if U.S.-located personnel engage in "back-office" activities with respect to a covered fund. The Supplementary Information also notes that U.S. personnel of a foreign banking entity may provide investment advice and recommend investment selections to the manager or general partner of a covered fund so long as it does not result in the U.S. personnel participating in the control of the covered fund or offering or selling an ownership interest to a resident of the United States. The Final Rule limits the definition of "resident of the United States" to mirror the definition of "U.S. person" in Regulation S.

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11. What is “Super 23A,” and what does it require?	“Super 23A” is a part of the proposed rule (and Final Rule) that prohibits transactions that would be “covered transactions” as defined in Section 23A of the Federal Reserve Act. It prohibits a banking entity or its affiliate from engaging in so-called “covered transactions” with a covered fund for which it serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or which it sponsors or organizes and offers or a covered fund controlled by such fund. “Covered transactions” include loans and other extensions of credit from the banking entity to the covered fund, purchases of assets by the banking entity from the covered fund and certain other specified transactions. As noted above, the proposed rule’s implementation of Super 23A would have severely limited many of the available exemptions provided for permitted covered funds, which were not exempt from Super 23A.	The Final Rule’s new exclusions from the definition of “covered fund” resolve the issue of the application of Super 23A to many permissible covered funds. Super 23A does, however, continue to apply as a blanket prohibition on “covered transactions” with sponsored and advised entities that are covered funds. The Supplementary Information clarifies that Super 23A does not include the “attribution rule” under Section 23A of the Federal Reserve Act.
D. Compliance Program and Certification Requirements		
12. What compliance program is required for banking entities subject to the Volcker Rule?	The proposed rule would have required a banking entity to implement a compliance program: • similar to that under “Standard” below if the banking entity engaged in any activity prohibited or restricted by the Volcker Rule; • similar to that under “Enhanced” below (but without a CEO certification or certain aspects of the senior-level governance requirements) if the banking entity had: (i) average trading assets and liabilities of $1 billion or more or equal to or greater than 10% of its total assets; (ii) owned an average of $1 billion in covered fund interests; or (iii) sponsored covered funds with assets of $1 billion or more; and • with the addition of quantitative trading metrics (in a greater number and variety than under the Final Rule) for banking entities with trading assets and liabilities of $1 billion or more, with a greater number of metrics reported for banking entities with trading assets and	The Final Rule continues to place great emphasis on compliance and to a large degree focuses at the trading desk level. Some components of the compliance regime remained largely unchanged from the proposed requirements, but there are a number of key differences, including: • relief for smaller banking entities; • different thresholds, with fewer banking entities having to report quantitative trading metrics but some larger banking entities becoming subject to enhanced compliance notwithstanding limited trading activities; and • an expanded corporate governance and oversight requirement, including an annual CEO certification under the “Enhanced” regime. The compliance programs required by the Final Rule are described in more detail below under the headings “Light,” “Standard, “Enhanced,” and “Enhanced with metrics.”

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	liabilities of $5 billion or more. Banking entities that did not engage in proprietary trading or covered fund activities needed only to have processes in place to prevent becoming engaged in such activities or investments in the future. The specific details of the compliance programs that would have been required under the proposed rule are not separately summarized in this memorandum.	
Light		Banking entities that do not engage in proprietary trading (other than permitted trading in U.S. government obligations) or covered fund activities need not establish the required compliance program. Banking entities with total consolidated assets of $10 billion or less that engage in proprietary trading (other than permitted trading in U.S. government obligations) and/or covered fund activities may satisfy their compliance obligations by including appropriate references to the requirements of the Volcker Rule in existing policies and procedures.
Standard		Banking entities in none of the other categories (i.e., with between $10 billion and $50 billion in total consolidated assets and not required to report quantitative trading metrics) must develop a compliance program that includes, at a minimum: • internal written policies reasonably designed to document, describe and monitor proprietary trading and covered fund activities; • a system of internal controls reasonably designed to monitor and identify potential areas of noncompliance and to prevent prohibited activities; • a management framework that clearly delineates responsibility and accountability for compliance, including appropriate management review; • independent testing for the effectiveness of the compliance program;

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		• training for the appropriate personnel; • recordkeeping sufficient to demonstrate compliance, which the banking entity must retain for at least 5 years and provide to the appropriate Agency upon request; and • a new requirement to document: (i) determinations that certain sponsored funds are not covered funds; (ii) the banking entity's plans for marketing any permitted fund seeding vehicle to third-party investors and converting it into a registered investment company or SEC-regulated business development company within the required time limit; and (iii) for U.S. banking entities, specific documentation of the value of ownership interests in foreign public funds and the jurisdictions of such funds' organization if the total amount of such interests exceeds $50 million.
Enhanced		A banking entity that must (i) report quantitative trading metrics (see below), (ii) has $50 billion or more in total consolidated assets or (iii) is otherwise designated by the appropriate Agency must implement an "enhanced" compliance program, in addition to implementing the requirements of the "standard" program, that includes the following. The CEO certification requirement is included in the "enhanced" compliance program (see below). With respect to proprietary trading activities: • policies and procedures governing each trading desk, including authorized instruments and appropriate risk levels; • a description of risks and risk management processes, including the management review process and escalation procedures; • internal controls to monitor and enforce risks limits; • policies and procedures regarding the use of hedging instruments and strategies; • robust analysis and quantitative measurement of trading activities, including periodic and independent back-

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		testing; • monitoring of compliance with the Volcker Rule and rationales for satisfaction of certain exemptions; and • remediation of violations. With respect to covered fund activities: • identification and documentation of covered funds and identification of covered fund activities and investments; • explanation of how the banking entity monitors for and prohibits violations of the prudential backstop provisions; • internal controls that, among other requirements, monitor and limit investments in covered funds, seed capital investments and levels of ownership; and • remediation of violations. In addition, the board of directors of the banking entity (or a committee thereof) and senior management must adopt the compliance program, and the board (or committee) must ensure that senior management is "fully capable, qualified, and properly motivated" to manage compliance.
Enhanced with metrics		A U.S. banking entity that has trading assets and liabilities (excluding U.S. government obligations) of $50 billion or more must begin reporting quantitative trading metrics to the appropriate Agency as of July 2014. Banking entities with trading assets and liabilities that equal or exceed $25 billion and $10 billion, respectively, must begin reporting as of May 2016 and January 2017, respectively. For foreign banking entities, the thresholds are applied to the trading assets and liabilities of "combined U.S. operations . . . operating, located or organized in the United States." The appropriate Agency may also determine that a banking entity must report quantitative trading metrics. Banking entities will be required to report the following seven metrics (reduced from a total of 17 under the proposed rule) on a monthly or quarterly basis (but calculated daily), depending on the amount of the banking entity's trading

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		assets and liabilities: • Risk and Position Limits and Usage; • Risk Factor Sensitivities; • VaR and Stress VaR; • Comprehensive P&L Attribution; • Inventory Turnover; • Inventory Aging; and • Customer Facing Trade Ratio. A banking entity that meets the $50 billion threshold for quantitative metrics reporting must provide these metrics to the appropriate Agencies every month. Reports for the previous month must be provided within 30 days after the end of the month, although this period is reduced to 10 days starting January 2015. Other banking entities subject to quantitative metrics reporting requirements must provide reports quarterly, and will have 30 days from the end of the quarter to do so. The metrics "will not be used as a dispositive tool" but "will be used to monitor patterns and identify activity that may warrant further review."
13. When are CEO certifications required?	The proposed rule did not include a CEO certification requirement, although the Agencies requested comment on the issue.	For banking entities subject to the "Enhanced" compliance program, the CEO must annually certify in writing to the appropriate Agency 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 Volcker Rule. In the case of a U.S. branch or agency of a foreign banking entity, the certification may be provided for the entire U.S. operations of the entity by the senior management officer of U.S. operations who is located in the United States. The precise timing and manner of submission of certifications are not clear.

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14. What other limitations apply to “material conflicts of interest” and “high-risk assets and trading strategies”?	Following the Dodd-Frank Act, the proposed rule included so-called “prudential backstops” that prohibit otherwise permissible proprietary trading and covered fund activities if the transaction, class of transactions or activity would: • involve a material conflict of interest between the banking entity and its clients, customers or counterparties; • result in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or • pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States. Transactions involving or resulting in a material conflict of interest were permitted if the banking entity had appropriately addressed and mitigated the conflict through either timely and effective disclosure or information barriers.	The Final Rule adopts the prudential backstops substantially as proposed. The definitions of “high-risk asset” and “high-risk trading strategy” are broadened to include assets and trading strategies that would pose a threat to the financial stability of the United States, or would significantly increase the likelihood that the banking entity would incur a substantial loss. Like the proposed rule, transactions entailing a material conflict of interest are prohibited, unless the banking entity has appropriately addressed and mitigated the conflict of interest through either timely and effective disclosure or information barriers.
15. How does the Volcker Rule affect compensation arrangements?	Each of the proposed exemptions for underwriting, market making-related and hedging activities required that the compensation arrangements of the persons performing the activities not be designed to reward proprietary risk taking.	The Final Rule maintains this requirement but alters the wording slightly to provide that compensation arrangements must not reward or incentivize *prohibited proprietary trading*, rather than any proprietary risk taking (which also occurs in the course of permitted activities). The Agencies noted that this requirement was not, for example, “intend[ed] to preclude an employee of an underwriting desk from being compensated for successful underwriting, which involves some risk-taking.”