

January 14, 2014

## Volcker Rule

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### **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**

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Earlier this evening, the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency (the "OCC"), Federal Deposit Insurance Corporation (such three agencies together, the "Banking Agencies"), Securities and Exchange Commission, and Commodity Futures Trading Commission (the "CFTC" and, collectively, the "Agencies") issued an interim final rule (the "Interim Final Rule") regarding the treatment of certain collateralized debt obligations backed by trust preferred securities ("TruPS-backed CDOs") under the final rule (the "Final Rule") implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commonly known as the "Volcker Rule." The Volcker Rule imposes broad restrictions on proprietary trading and investing in and sponsoring private equity and hedge funds ("covered funds") by banking organizations and their affiliates.

The Interim Final Rule—which does not technically amend the Final Rule but will operate as a "companion rule" to the Final Rule—specifies that the Volcker Rule's covered fund restrictions do not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer of TruPS-backed CDOs if three conditions (described below) are met. The Interim Final Rule is open for public comment on all aspects, and specifically whether the Interim Final Rule is consistent with the purposes of the Volcker Rule and Section 171 of the Dodd-Frank Act (the so-called "Collins Amendment"). Comments on the Interim Final Rule are due on or before 30 days after publication of the Interim Final Rule in the Federal Register.

Contemporaneously with the Agencies' release of the Interim Final Rule, the Banking Agencies issued a non-exclusive list of issuers of TruPS-backed CDOs that meet the requirements of the Interim Final Rule.

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The Interim Final Rule provides that a banking entity “may rely” on this list. A copy of the list is attached as Appendix A.

The three conditions to the exemption for an issuer of TruPS-backed CDOs under the Interim Final Rule are:

- (1) the issuer was established, and the interest was issued, before May 19, 2010;<sup>1</sup>
- (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 the interest on or before December 10, 2013<sup>2</sup> (or acquired the interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before that date).<sup>3</sup>

The Interim Final Rule defines the term “Qualifying TruPS Collateral” as “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.” The Agencies note in the preamble to the Interim Final Rule that, by using the phrase “invested primarily,” they intend to cover “securitization vehicles that have invested a majority of their offering proceeds in Qualifying TruPS Collateral.”<sup>4</sup> The preamble also provides that the Agencies included a “reasonable belief” standard “since the relevant CDOs were structured and [banking entities] made their investments many years ago and all of the relevant documentation may not be readily available to banking entities.”

The Interim Final Rule follows a period of significant uncertainty with respect to the treatment of TruPS-backed CDOs under the Volcker Rule. The Final Rule, issued by the Agencies on December 10, 2013, included an expanded definition of “ownership interest” with respect to covered funds, potentially prohibiting banking organizations from continuing to own TruPS-backed CDOs. As a result, banking organizations have been concerned that they may be required to divest their ownership of TruPS-backed

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<sup>1</sup> This date relates to the Collins Amendment, which provides for the permanent grandfathering in regulatory capital of TruPS issued before May 19, 2010 by certain depository institution holding companies with total consolidated assets of less than \$15 billion. The Agencies stated that “appropriately reconcil[ing] the policies of [the Volcker Rule] with its companion provision in [the Collins Amendment]” was one of the goals of the Interim Final Rule.

<sup>2</sup> December 10, 2013 is the date on which the Agencies approved and published the Final Rule.

<sup>3</sup> The Interim Final Rule clarifies that, notwithstanding this requirement (3), a banking entity may act as a market maker with respect to the interests of an issuer of TruPS-backed CDOs in accordance with the applicable provisions of the Final Rule.

<sup>4</sup> The preamble notes that the Agencies expect that the Interim Final Rule will cover all of the issuers that were formed primarily for the purpose of investing in Qualifying TruPS Collateral, and the Agencies specifically request comment regarding whether a different approach is necessary to accomplish this objective.

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CDOs by the end of the conformance period under the Volcker Rule—generally July 21, 2015—and may therefore be required under generally accepted accounting principles to take an immediate write-down of any of these securities with a fair value less than their carrying value.

In response to concerns raised by a number of banking organizations after release of the Final Rule, the Banking Agencies initially issued an “FAQ Regarding Collateralized Debt Obligations Backed by Trust Preferred Securities under the Final Volcker Rule” on December 19, 2013. The FAQ did not, however, provide sufficient clarity with respect to whether banking organizations would in fact be required to divest certain TruPS-backed CDOs. On December 27, 2013, the Agencies (excluding the CFTC) issued a joint statement noting that the Agencies were reviewing whether it would be appropriate and consistent with the provisions of the Dodd-Frank Act not to subject TruPS-backed CDOs to the prohibitions on ownership of covered funds under the Volcker Rule.<sup>5</sup> The intent of this joint statement appeared to be to forestall further announcements of immediate write-downs pending the Agencies’ review. The joint statement also noted that “the accounting staffs of the Agencies believe that, consistent with generally accepted accounting principles, any actions in January 2014 that occur before the issuance of December 31, 2013 financial reports, including the FR Y-9C and the Call Report, should be considered when preparing those financial reports.”

The Interim Final Rule should provide welcome relief for the holders of TruPS-backed CDOs that qualify for the exemption. It should be noted, however, that the Interim Final Rule may not exempt all TruPS-backed CDOs and does not provide any guidance on how the term “ownership interest” in the Final Rule is to be construed as applied to other securities that are structurally similar to TruPS CDOs—for example, debt securities of collateralized loan obligations (CLOs). Even with respect to those TruPS-backed CDOs that are exempt under the Interim Final Rule, banking organizations may need to act quickly—and in advance of pending deadlines for reporting of 2013 financial results—to establish and document with their accountants that their holdings comply with the Interim Final Rule’s requirements at a confidence level that will support non-write-down of those holdings under applicable auditing standards.<sup>6</sup>

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<sup>5</sup> Please see our Memorandum to Clients, dated December 27, 2013, “[Agencies Reviewing Applicability of Volcker Rule to TruPS-Backed CDOs; Intent Appears to Be to Forestall Immediate Write-Downs.](#)”

<sup>6</sup> Please also see our Memorandum to Clients, dated December 13, 2013, “[Agencies Approve Long-Awaited Final Rule; Most Requirements to Take Effect on July 21, 2015.](#)” for an initial overview of certain key requirements of the Final Rule.

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**Board of Governors of the Federal Reserve System  
Federal Deposit Insurance Corporation  
Office of the Comptroller of the Currency**

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**January 14, 2014**

**Agencies Release Non-Exclusive List of Qualified Collateralized Debt Obligations Backed  
Primarily by Trust Preferred Securities**

Three federal banking agencies on Tuesday issued a non-exclusive list of collateralized debt obligations backed by trust preferred securities (TruPS CDOs) for use in determining compliance with an interim final rule issued earlier in relation to section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

On January 14, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, and the Commodity Futures Trading Commission adopted an interim final rule (IFR) on the treatment of certain TruPS CDOs for purposes of the final rule implementing section 619 of the Dodd-Frank Act, also known as the Volcker rule, which was adopted by the agencies on December 10, 2013.

The federal banking agencies have reviewed the available data on TruPS CDOs and the agencies will recognize the issuers listed as meeting the requirements of the new section \_\_\_\_.16, which the IFR adds to the final rule. However, if a banking entity owns an investment in a TruPS CDO that it determines qualifies for exemption under section \_\_\_\_.16(a), the fact that the TruPS CDO is not included on this list does not preclude its treatment as an exempt issuer.

As with all debt and equity investments, banking entities should continue to measure, monitor, and control the inherent risks of TruPS CDO holdings. Existing regulations and supervisory guidance will continue to apply, as will prudential safety and soundness considerations and examination coverage. Consequently, investments in these specific TruPS CDOs remain subject to the federal banking agencies' guidance on complex structured credit products and the 2013 *Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions*.<sup>1</sup>

Banking entities must continue to account for their holdings of these securities in accordance with the relevant U.S. generally accepted accounting principles. For further information, banking entities should refer to Accounting Standards Codification (ASC) Topic 320, Investments-Debt and Equity Securities, ASC Subtopic 325-40, Investments-Other-Beneficial

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<sup>1</sup> For the Board refer to SR 13-18, for the FDIC refer to FIL-51-2013, and for the OCC, refer to OCC Bulletin 2013-08, "[Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions](#)."

Interests in Securitized Financial Assets, and the Glossary entry for “Securities Activities” in the instructions for the Consolidated Reports of Condition and Income (Call Report).<sup>2</sup>

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For questions regarding the list, please email [CapitalMarkets@fdic.gov](mailto:CapitalMarkets@fdic.gov) or call (202) 898-6888.

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<sup>2</sup> See A-72 in “Instructions for Preparation of Consolidated Reports of Condition and Income,” located at [http://www.ffiec.gov/pdf/FFIEC\\_forms/FFIEC031\\_FFIEC041\\_201309\\_i.pdf](http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201309_i.pdf)

**Non-Exclusive List of TruPS CDOs that Are Not Covered Funds:**

- ALESCO Preferred Funding I
- ALESCO Preferred Funding II
- ALESCO Preferred Funding III
- ALESCO Preferred Funding IV
- ALESCO Preferred Funding V
- ALESCO Preferred Funding VI
- ALESCO Preferred Funding VII
- ALESCO Preferred Funding VIII
- ALESCO Preferred Funding IX
- ALESCO Preferred Funding X
- ALESCO Preferred Funding XI
- ALESCO Preferred Funding XII
- ALESCO Preferred Funding XIII
- ALESCO Preferred Funding XIV
- ALESCO Preferred Funding XV
- ALESCO Preferred Funding XVI
- ALESCO Preferred Funding XVII
- MM Community Funding
- MM Community Funding II
- MM Community Funding III
- MM Community Funding IX
- MMCapS Funding I
- MMCapS Funding XVII
- MMCapS Funding XVIII
- MMCapS Funding XIX
- Preferred CPO
- Preferred Term Securities I
- Preferred Term Securities II
- Preferred Term Securities III
- Preferred Term Securities IV
- Preferred Term Securities V
- Preferred Term Securities VI
- Preferred Term Securities VII
- Preferred Term Securities VIII
- Preferred Term Securities IX
- Preferred Term Securities X
- Preferred Term Securities XI
- Preferred Term Securities XII
- Preferred Term Securities XIII
- Preferred Term Securities XIV
- Preferred Term Securities XV
- Preferred Term Securities XVI



- Preferred Term Securities XVII
- Preferred Term Securities XVIII
- Preferred Term Securities XIX
- Preferred Term Securities XX
- Preferred Term Securities XXI
- Preferred Term Securities XXII
- Preferred Term Securities XXIII
- Preferred Term Securities XXIV
- Preferred Term Securities XXV
- Preferred Term Securities XXVI
- Preferred Term Securities XXVII
- Preferred Term Securities XXVIII
- Regional Diversified Funding
- Regional Diversified Funding 2004-1
- Regional Diversified Funding 2005-1
- Soloso CDO 2005-1
- Soloso CDO 2007-1
- TPref Funding I
- TPref Funding II
- TPref Funding III
- Trapeza CDO I
- Trapeza CDO II
- Trapeza CDO III
- Trapeza CDO IV
- Trapeza CDO V
- Trapeza CDO VI
- Trapeza CDO VII
- Trapeza Edge CDO
- Trapeza CDO IX
- Trapeza CDO X
- Trapeza CDO XI
- Trapeza CDO XII
- Trapeza CDO XIII
- Tropic CDO I
- Tropic CDO II
- Tropic CDO III
- Tropic CDO IV
- Tropic CDO V
- U.S. Capital Funding I
- U.S. Capital Funding II
- U.S. Capital Funding III
- U.S. Capital Funding IV
- U.S. Capital Funding V
- U.S. Capital Funding VI