Debevoise In Depth

Volcker Rule: A “Best First Effort” Paving the Way for More

July 17, 2018

On Tuesday, June 5, 2018, the Federal Reserve Board (the “FRB”), the Commodity Futures Trading Commission (the “CFTC”), the Federal Deposit Insurance Corporation (the “FDIC”), the Office of the Comptroller of the Currency (the “OCC”), and the Securities and Exchange Commission (the “SEC,” collectively with the FRB, CFTC, FDIC and OCC, the “Agencies”) jointly released proposed revisions (the “Proposal”) to the regulations implementing section 13 (commonly known as the “Volcker Rule”) of the Bank Holding Company Act (the “BHC Act”). The Proposal (available here) was published in the Federal Register today, with a comment period that closes on September 17, 2018.

The Proposal is an important step forward, but as FRB Vice Chairman Quarles stated when the FRB voted on the Proposal, it appears to be a “best first effort.” That is, although the Proposal puts forward a number of specific revisions to the Volcker Rule, on many important topics, the Proposal defers on putting forward specific changes and, instead, requests more open-ended comments. In addition, in some of the areas where the Agencies propose specific changes, such as the scope of the proprietary trading provisions and the exemption for market making-related activities, the Proposal is either somewhat modest or introduces new complexities that need to be addressed. As a result, we believe this Proposal indeed represents a first effort, and that the public comment process will be critical to provide the Agencies with the information and detail needed to improve their implementation of the Volcker Rule.

Below is a summary of the way the Proposal would change the Volcker Rule’s proprietary trading, covered funds, and compliance program requirements. We also highlight some of the Proposal’s requests for comment. For reference, a redline showing the proposed changes to the regulatory text is available here.

Table of Contents

Proprietary Trading

Revisions to the Definition of "Trading Account"

Under the Volcker Rule, proprietary trading is defined as "engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments." A "trading account," in turn, is defined using a three-prong test. The first prong (the "purpose prong") includes any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of: (1) short-term resale; (2) benefitting from short-term price movements; (3) realizing short-term arbitrage profits; or (4) hedging any of the foregoing. Under the purpose prong, there is a rebuttable presumption that a purchase or sale of a financial instrument is for the trading account if the banking entity holds the financial instrument for fewer than 60 days or substantially transfers the risk of the position within 60 days.

The second prong (the "market risk capital prong") applies to the purchase or sale of financial instruments that are both market risk capital rule "covered positions" and "trading positions." The third prong (the "status prong") applies to the purchase or sale of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, as a dealer, swap dealer, or security-based swap dealer, to the extent that the instrument is purchased or sold in connection with activities that require the banking entity to be licensed or registered as such, as well as equivalent foreign activity.

The Proposal would revise the trading account definition by replacing the purpose prong and the 60-day rebuttable presumption with a new "accounting prong." The proposed accounting prong would include in the trading account any purchase or sale of a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards. Such instruments would include, for example, derivatives, trading securities, and available-for-sale securities. Although the accounting prong would provide a bright line test for banking entities, as proposed, it is substantially broader than the purpose prong, primarily because available-for-sale securities encompass a wide range of securities not necessarily held for short-term trading purposes (*e.g.*, corporate bonds held for investment).

The Proposal also would introduce a presumption of compliance under the accounting prong. Pursuant to this presumption, a trading desk that purchased or sold financial instruments for a trading account pursuant to the accounting prong would calculate the net gain or loss on the trading desk's portfolio of financial instruments on each day, reflecting both realized and unrealized gains and losses since the previous business day. If the sum of the absolute values of the daily net gain and loss amounts for the preceding 90-calendar-day period ("absolute P&L") does not exceed $25 million, all activities of that trading desk would be presumed to be in compliance with the Volcker Rule's proprietary trading prohibition. For example, a trading desk that alternated between daily gains and losses of $200,000 each day for 90 calendar days would have $18 million of absolute P&L and, therefore, presumptively would be compliant with the Volcker Rule's proprietary trading prohibition. A trading desk that crossed the $25 million absolute P&L threshold would be required to notify the appropriate Agency and would not benefit from the presumption.

Although the Proposal would largely retain both the market risk capital prong and status prong, the Proposal would modify the market risk capital prong to include accounts used by foreign banking entities to purchase or sell one or more financial instruments that are subject to capital requirements under a market risk framework established by the banking entity's home-country supervisor. Such framework would have to be consistent with the market risk framework published by the Basel Committee on Banking Supervision. For example, positions held by a European bank subject to the market risk provisions of the applicable implementation of the EU Capital Requirements Regulation would be for a "trading account," regardless of the classification of the position under the U.S. market risk capital rule.

Expansion of Liquidity Management Exclusion

Currently, the regulations implementing the Volcker Rule exclude from the definition of proprietary trading the purchase or sale of securities for the purpose of liquidity management in accordance with a documented liquidity management plan, provided that the banking entity meets certain additional conditions (the "liquidity management exclusion"). Notably, the liquidity management exclusion is limited to purchases or sales of *securities* for the purpose of liquidity management. The Proposal would amend the liquidity management exclusion to permit banking entities to rely on the liquidity management exclusion with respect to certain foreign exchange forwards and swaps (as defined in the Commodity Exchange Act), and certain physically settled cross-currency swaps. For example, under the Proposal, foreign branches and subsidiaries of U.S. banking entities that are subject to foreign liquidity requirements may be able to rely on the liquidity management exclusion when trading foreign exchange products to manage currency risk arising from holding liquid assets in foreign currencies.

Trade Error Exclusion

Banking entities have expressed concern that, under the current regulations implementing the Volcker Rule, trading errors and any transactions entered into to correct a trading error could fall within the definition of proprietary trading. In response, the Proposal introduces a new exclusion from the definition of proprietary trading for trading errors and subsequent correcting transactions (the "trade error exclusion"). In order to rely on the trade error exclusion, once a banking entity identifies purchases made in error, it would be required to transfer the relevant financial instrument to a separately managed trade error account. The applicability of the trade error exclusion would depend on the facts and circumstances of the transactions. For example, a banking entity may not be allowed to depend on the trade error exclusion if the magnitude or frequency of errors suggests that the entity did not make reasonable efforts to prevent errors from occurring, or if the entity failed to identify and correct trade errors in a timely and appropriate manner.

Definition of Trading Desk

Under the current regulations implementing the Volcker Rule, "trading desk" is defined as "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." In response to significant industry comment on the ambiguity of this definition and the inconsistencies that can arise with how banking entities define trading desks in practice, the Proposal requests comment on potential revisions to how "trading desk" is defined. Possible revisions include using a multi-factor definition and subjecting banking entities' trading desk designations to Agency review. Broadly speaking, the Proposal solicits comments on ways in which the definition of trading desk could be easier to monitor and for banking entities to apply (Question 58).

Reservation of Authority

The Proposal would introduce a reservation of authority that would allow the Agencies to determine, on a case-by-case basis, whether certain purchases and sales are for the trading account. In making these determinations, the Agencies would consider consistency with the statutory definition, and may consider other factors, including the impact of the activity on the safety and soundness of the financial institution or the financial stability of the United States, or the risk characteristics of the particular activity. Requests for determinations would be subject to notice and response procedures.

Permitted Underwriting and Market Making-Related Activities

The Volcker Rule contains exemptions from the prohibition on proprietary trading for underwriting and market making-related activities, to the extent that such activities are designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties ("RENTD").

The Agencies state that the Proposal is intended to simplify the requirements for banking entities that seek to rely on these exemptions by providing that purchases or sales of financial instruments by a banking entity would be presumed to be designed not to exceed, on an ongoing basis, RENTD, if the banking entity establishes internal risk limits for each trading desk, and implements, maintains, and enforces those limits.

For underwriting activities, a banking entity's internal RENTD limits would be required to be based on three factors: (1) the amount, types, and risk of its underwriting position; (2) the level of exposures to relevant risk factors arising from its underwriting position; and (3) the period of time that a financial instrument may be held. For market making-related activities, a banking entity's internal RENTD limits would be based on four factors: (1) the amount, types, and risks of its market maker positions; (2) the amount, types and risks of the products, instruments, and exposures that 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 that a financial instrument may be held. In each case, these are the same factors used in the current implementing regulations.

Also, in each case, the banking entity would be required to promptly notify the applicable Agency if the limits are increased or breached, creating a significant new compliance requirement. Further, the applicable Agency could rebut the presumption of compliance based on a determination that a trading desk is engaged in activity that does not adhere to the RENTD requirement. The Proposal also would eliminate the specific compliance program requirements under these exemptions for banking entities with moderate or limited trading assets and liabilities (these categories are described in more detail below).

Permitted Risk-Mitigating Hedging

The Volcker Rule provides an exemption from the prohibition against proprietary trading for risk-mitigating hedging activities that are designed to reduce the specific risks to a banking entity in connection with, and related to, individual or aggregated positions, contracts or other holdings. Although the exemption is conceptually broad, in practice, many banking entities have found it difficult to rely on the exemption due to the requirement in the implementing regulations that banking entities engage in "correlation analysis" and that banking entities show that risk-mitigating hedging activity "demonstrably reduces or otherwise significantly mitigates" specific risks.

In response to these concerns, the Proposal would remove the correlation analysis requirement and the requirement to show that a hedge "demonstrably reduces or otherwise significantly mitigates" a specific risk. The Proposal also would significantly reduce the compliance requirements applicable to this exemption for banking entities that do not have significant trading assets and liabilities. The Proposal would eliminate certain documentation requirements for banking entities with significant trading assets and liabilities that apply to cross-desk and aggregated hedges.

Clarification Regarding Loan-Related Swaps

Under the proposed accounting prong, entry into loan-related swaps[1] would be considered proprietary trading if the swap were to be recorded at fair value on a recurring basis under applicable accounting standards. Consequently, a banking entity would need to rely on an applicable exemption from the definition of proprietary trading (*e.g.*, the exemption for market making-related activities). Because a banking entity's entry into loan-related swaps may be infrequent and ultimately situational, the Proposal requests comment on, among other subjects, whether loan-related swaps should be permitted under the exemption for market making-related activities

---

1 Loan-related swaps are swaps that a banking entity enters into in connection with a loan to a customer. The banking entity may enter into an offsetting transaction with a third party to offset its exposure on the customer swap.

(Question 101) or whether they should be excluded entirely from the scope of proprietary trading (Question 104).

Clarification Regarding Market Making-Related Hedging

The Proposal requests comment on a number of issues regarding the circumstances under which banking entities may elect to rely on either the exemption for market making-related activities or the risk-mitigating hedging exemption. Examples include whether trading desks may treat affiliated trading desks as a client, customer, or counterparty for purposes of the RENTD requirement and the circumstances under which a trading desk may undertake market-making risk management activities for one or more other trading desks.

Expanding the TOTUS Exemption

The Volcker Rule permits certain foreign banking entities to engage in proprietary trading activities that occur solely outside of the United States (the "TOTUS" exemption). The current implementing regulations include several conditions to the availability of the TOTUS exemption. The Proposal would eliminate various of these conditions, refocusing the TOTUS exemption on whether the banking entity, along with any relevant personnel, that engages in the purchase or sale as principal is located outside of the United States. The modification would clarify that some limited involvement by U.S. personnel (*e.g.*, arranging and negotiating) could be consistent with the TOTUS exemption so long as the *principal* risk and actions of the purchase or sale do not take place in the United States. This clarification would provide greater flexibility to foreign banking entities that rely on the TOTUS exemption, thereby implementing the statute's extraterritorial limit for the Volcker Rule.

Covered Funds and Banking Entity Status Issues

"Covered Fund" Definition and Exclusions

The Agencies do not propose revisions to the base definition of "covered fund" or the current exclusions from the definition. Instead, the Agencies request comment on these issues. Some of the more significant requests for comment are outlined below.

- **"Covered fund" definition**. The implementing regulations do not separately define "hedge fund" and "private equity fund," which are the terms used in the statute to define the scope of funds subject to the Volcker Rule, but instead create a unified definition for "covered funds." The Agencies ask whether this approach should be changed, including whether the terms "hedge fund" and "covered fund" should be defined separately (Question 131). Further, the Agencies ask whether they should revise the "covered fund" base definition using a characteristics-based approach (Questions 171).

- **Exclusions**. Alternatively, the Agencies ask about excluding from the definition of "covered fund" those issuers that do not share characteristics common to a hedge fund or private equity fund (Questions 160-164). These questions specifically refer to the definition of "hedge fund" and "private equity fund" found in the SEC's Form PF. A revised exclusion could refer to the Form PF definitions or new ones designed by the Agencies based on Form PF. The Agencies also ask whether other specific types of issuers should be excluded from the "covered fund" definition (*e.g.*, Questions 135, 181-2). Given the current over breath of the "covered fund" definition and its incongruity with other aspects of the BHC Act, pursuing additional exclusions may be a useful route for the Agencies and the industry.

- **Foreign public funds**. The Agencies indicate that they are considering multiple ways to revise the exclusion to the "covered fund" definition for foreign public funds ("FPFs"). For example, the current exclusion requires that the issuer be organized or established outside of the United States and that its ownership interests be authorized to be offered and sold to retail investors in the issuer's "home jurisdiction" and sold predominantly through one or more "public offerings" outside of the United States. The Agencies ask whether the "home jurisdiction" requirement should be modified to accommodate FPFs that may be organized in one jurisdiction but sold in others, such as a European Undertaking for Collective Investment in Transferrable Securities, or UCITS (Questions 144, 146). In addition, the Agencies ask whether the "public offering" requirement should be revised to accommodate FPFs that may be sold through private offerings to institutional investors (Question 147).

Hedging fund-linked products

When finalizing the current implementing regulations, the Agencies declined to allow 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. In a reversal from the Agencies' prior position, the Proposal would include this provision and seeks comment on it (Question 186) and would retract the prior determination that such transactions represented a high-risk strategy that could threaten the safety and soundness of a banking entity.

SOTUS Exemption

Foreign banking entities benefit from an exemption to the covered funds prohibition for covered fund investment and sponsorship that occurs "solely outside of the United States" (the "SOTUS" exemption). Among other conditions, this exemption requires that the foreign banking entity not use U.S. financing for such covered fund activities and that ownership interests in the relevant covered fund not be offered for sale or sold to a U.S. resident. The Proposal would codify Frequently Asked Question ("FAQ") No. 13, issued by the Agencies' staffs, which provides that SOTUS is available for investing in covered funds, so long as the foreign banking entity does not participate in the offer or sale of ownership interests to U.S. residents. The Proposal also would remove the U.S. financing restriction.

Super 23A

The Volcker Rule includes the so-called "Super 23A" restriction, which prohibits "covered transactions" (as defined in Federal Reserve Act section 23A) between a banking entity that sponsors, advises, or manages a covered fund (or any of such banking entity's affiliates) and the covered fund and any covered fund controlled by the first covered fund. When developing the implementing regulations, the Agencies determined that the Volcker Rule's Super 23A restrictions do not benefit from the exemptions contained in Federal Reserve Act section 23A or the FRB's Regulation W thereunder. The Agencies ask whether this approach should be modified (Question 198).

The implementing regulations' Super 23A provisions include an exemption for certain "prime brokerage" transactions. One of the conditions to this exemption is that the banking entity's CEO certify in writing annually 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. The Proposal would codify staff FAQ No. 18, by providing that a banking entity must provide the CEO certification annually no later than March 31 of the relevant year.

In addition, the Proposal would support the CFTC's position that Super 23A's restrictions would not apply to futures commission merchants ("FCMs") providing futures, options, and swaps clearing services to covered funds for which affiliates of the FCM are engaged in activity that implicates Super 23A.[2]

Banking Entity Definition

Because the Proposal would not revise the "covered fund" definition and exclusions, the banking entity status issue for U.S. registered investment companies ("RICs"), FPFs, and foreign excluded funds ("FEF") would remain unresolved. Under the implementing regulations, this issue arises because RICs, FPFs and FEFs are not covered funds and, therefore, unlike covered funds (which are carved out from the "banking entity" definition), may be banking entities themselves. For most such vehicles, being a banking entity and being subject to the Volcker Rule's proprietary trading and covered

---

2 CFTC Staff Letter 17-18 (Mar. 29, 2017).

funds prohibitions would be fundamentally inconsistent with their business. To address this issue, the Agencies and other staffs previously issued guidance or other statements: (1) to provide relief for FPFs that may be banking entities as a result of governance or contractual arrangements (FAQ No. 14); (2) clarifying that multi-year seeding periods are available for RICs and FPFs (FAQ No. 16); and (3) to provide no-action relief for certain FEFs that may be banking entities.[3] Notably, the Agencies emphasize that FAQ No. 16 does not set "any maximum prescribed period for a RIC or FPF seeding period."

The Agencies ask questions about how to deal with these issues, including whether banking entities should be permitted to treat certain entities, including FEFs, as covered funds (Question 20). This latter approach would allow banking entities to opt-in an FEF to covered fund status and then conform its investment in and relationship with the fund to the conditions of the SOTUS exemption (the so-called "SOTUS opt-in" approach).

Compliance Requirements and Metrics

Compliance

The Proposal would establish three tiers of banking entities, based on dollar amount of trading assets and liabilities (excluding obligations of or guaranteed by the U.S. government). Each tier would be subject to differing compliance obligations as highlighted below.

- **Significant trading assets and liabilities**: ≥ $10 billion, measured for U.S. banking entities on a global basis and for foreign banking entities with respect to U.S. operations. These banking entities would be subject to the six-pillar compliance program and the CEO attestation requirements.

- **Moderate trading assets and liabilities**: Not in the other two categories. These banking entities, which would be subject to the CEO attestation, would be permitted to implement a simplified compliance program that references the statutory requirements in existing policies, procedures, and compliance programs.

- **Limited trading assets and liabilities**: < $1 billion, measured on a global basis for U.S. and foreign banking entities. These banking entities would benefit from a rebuttable presumption of compliance and, when operating under that presumption, would not have an affirmative obligation to demonstrate compliance.

---

[3] For more information on FAQ No. 14, No. 16, and a discussion of the no-action relief for FEFs, please see our prior Client Updates here, here, and here, respectively.

For a further review of the changes to the compliance programs and how each applies to different tiers of trading activity, please refer to Exhibit 1. Notable changes are further described below:

- **Appendix B**: the Proposal would eliminate Appendix B, which outlined the "Enhanced Minimum Standards" for compliance. The Agencies note that the requirements are unnecessarily duplicative of the six-pillar compliance program and banking entities could accommodate these requirements in their existing compliance programs.

- **CEO Attestation**: as noted above, this requirement would be retained for banking entities with moderate and significant trading assets and liability levels.

- **Appendix A (metrics)**: this appendix of reportable metrics would be retained but would be revised considerably, including by adding new requirements. This is discussed in greater detail in the section that follows.

In addition, the Agencies generally request comment on the issue of interagency coordination. For example, they ask what specific steps with respect to Agency coordination would be helpful to make compliance with the Volcker Rule more efficient (Questions 1-2).

Metrics

Changes to Definitions and Scope

The Proposal would replace the metrics for "Inventory Turnover" and "Customer-Facing Trade Ratio" with "Positions" and "Transaction Volumes," respectively. The Proposal also would modify the scope of "Inventory Aging" to apply only to securities and not derivatives and would clarify so by renaming the metric "Securities Inventory Aging." These three new metrics are further discussed below.

The Proposal also would provide that the Positions, Transaction Volumes, and Securities Inventory Ageing metrics would be applicable only to trading desks that rely on the underwriting or market making-related activities exemptions. Further, the Proposal would add a definition for "trading day" to clarify the calendar day, regardless of jurisdiction or location, on which there is trading activity. Under this change, banking entities only would be required to calculate and report the applicable metrics for days on which the trading desk is open for trading activity.

Trading Desk Information

For each trading desk, the Proposal would require banking entities to identify individual trading desks and provide a trading desk name and identifier. The trading desk name and identifier would change with the structure and life cycle of a trading desk. As such, if a banking entity restructured its operations and, for example, merged two trading desks, the trading desk name and identifier would have to change accordingly.

The Proposal would require banking entities to identify each trading desk's types of covered trading activity (*e.g.*, underwriting, market making-related activities, risk-mitigating hedging, etc.).

Banking entities would be required to provide a description of the trading desk, including its general strategy, and a summary of all financial instruments purchased and sold. The summary would include identifying which financial instruments are the main products purchased and sold. For market making-related activities, banking entities would be required to specify which financial instruments are and are not included in market-making positions. Banking entities would have the flexibility to include products not otherwise included in the definition of "financial instruments," *e.g.*, loans, spot commodities, spot foreign exchange, and currency. The approach to these excluded products would need to be consistent, and the Proposal would require banking entities to identify whether excluded products were included in the metrics reported and provide an explanation of excluded products.

The Proposal would require banking entities to identify each legal entity that serves as a booking entity for each trading desk and to identify which legal entity serves as each trading desk's main booking entity. Banking entities also would be required to specify the legal entity type, from a prescribed list, corresponding to each booking entity. Banking entities would have to note and describe instances where the entity types provided do not correspond to the legal entity type of the booking entity.

Lastly, the Proposal would require banking entities to identify each calendar day that serves as a trading day and the currency and the conversion rate for any metrics calculated in currencies other than U.S. dollars.

Proposed Information Schedules

The Proposal would include a number of new schedules, with both quantitative and qualitative information, and cross-referencing schedules and ratios.

Risk and Positions Limits Information Schedule	Risk Factor Sensitivities Information Schedule	Risk Factor Attribution Information Schedule
This schedule would require detailed information on each limit reported in the Risk and Position Limits and Usage Risk-Management	This schedule would report each risk factor sensitivity reported in the Risk Factor Sensitivity Risk-Management measurement. Information would include	This schedule would report each profit and loss attribution reported in the Comprehensive Profit and Loss Attribution measurement. Information

measurements. Information would include the limit name, description, unit of measurement, and type of limit.	the name, description, and change unit of each risk factor sensitivity.	would include the name, description, and change unit of each risk factor.

Limit/Sensitivity Cross-Reference Schedule	**Risk Factor Sensitivity/Attribution Cross-Reference Schedule**
This schedule would cross-reference each limit reported in the Risk and Positions Limits Information Schedule with its associated risk factor sensitivity in the Risk Factor Sensitivities Information Schedule.	This schedule would cross-reference each risk factor sensitivity reported in the Risk Factor Sensitivities Information Schedule with its associated risk factor attribution reported in the Risk Factor Attribution Information Schedule.

Narrative Statements

The Proposal would require banking entities to submit a narrative statement describing any changes in their internal calculation methods, including a description of the change and the effective date of the change, and any changes in a banking entity's trading desk structure (*e.g.*, adding, terminating, or merging pre-existing desks).

Frequency of Reporting

For banking entities with $50 billion or more in trading assets and liabilities, the Proposal would extend the reporting deadline from within 10 days of the end of each calendar month to within 20 days of the end of each calendar month.

Other Changes to Metrics

- **Risk and Position Limits and Usage**: The Proposal would remove references to Stressed Value-At-Risk. The Proposal also would require that, where available, an upper and lower limit should be included.

- **Risk Factor Sensitivities:** The Proposal would require banking entities to report risk factor sensitivities (as identified in the Risk Factor Sensitivities Information Schedule), magnitude of change in the risk factor, and aggregate change in value.

- **Value-At-Risk and Stressed Value-At-Risk**: The Proposal would eliminate the requirement of reporting Stressed Value-At-Risk for trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of financial instrument.

- **Comprehensive Profit and Loss Attribution**: The Proposal would remove the volatility of comprehensive profit and loss reporting. For one or more factors explaining the preponderance of profit and loss changes due to risk factor changes, the Proposal would require identifying and reporting the unique identification label for the factor and the profit or loss due to the risk factor change.

- **Positions and Inventory Turnover**: As noted earlier, the Proposal would replace the Inventory Turnover metric with a Positions metric, which would allow the Agencies the ability to calculate inventory turnover ratios over any time period (in comparison to the current daily, 30-day, 60-day, and 90-day calculation periods). This metric would be limited to trading desks that conduct underwriting activity or market making-related activities. For these desks, banking entities would be required to report the value of securities and derivative positions managed and would include all covered trading activities conducted by these desks. The market value of long and short securities positions, derivative receivables and payables, and notional value of derivative receivables and payables also would be separately reported. Lastly, the new Positions metric would differentiate between "securities" and "derivatives" by requiring separate reports for each.

- **Securities Inventory Aging**: The Proposal would limit the new Securities Inventory Aging metric to trading desks' securities positions (and would eliminate the requirement to include derivatives) and would require banking entities to report the age profile through security-asset aging and liability-aging schedules. The Proposal would further limit the metric by focusing on underwriting and market making-related activities. For these desks, banking entities would be required to include all covered trading activities conducted by these desks. Age-range would be limited to: 0-30, 31-60, 61-90, 91-180, 181-360, and 360+ calendar days.

- **Transaction Volumes and Customer-Facing Trade Ratio**: As noted earlier, the Proposal would replace the Customer-Facing Trade Ratio metric with a Transaction Volumes metric. The current Customer-Facing Trade Ratio compares transactions by a customer counterparty with transactions by a non-customer counterparty (the numerator represents customer counterparties and the denominator represents non-customer counterparties). The Proposal states that the Agencies have not found this ratio to provide meaningful information. In addition, the current ratios are computed by trade and value and are calculated on a daily basis for 30-day, 60-day, and 90-day calculation periods. The Proposal notes that the Agencies would like the flexibility to calculate customer-facing trade ratios over any period of time.

- The Transaction Volumes metric would calculate the number and value of all securities and derivatives transactions conducted for underwriting or market making-related activity, for each trading day, with: (1) customers; (2) non-customers; (3) trading desks and other organizational units where the transaction is booked into the same banking entity; and (4) trading desks and other organizational units where the transaction is booked into an affiliated banking entity. Banking entities would be required to include all covered trading activities conducted by these desks. The four categories would be exclusive of each other, meaning that a transaction would be reported in only one category.

- Lastly, the Proposal would require banking entities to not include in "securities" those securities that are also "derivatives," as defined in the regulations implementing the Volcker Rule. Instead, securities that are also "derivatives" would be accounted for under "derivatives."

* * *

Please do not hesitate to contact us with any questions.

NEW YORK

Gregory J. Lyons
gjlyons@debevoise.com

David L. Portilla
dlportilla@debevoise.com

Jennifer T. Barrows
jbarrows@debevoise.com

N. Angelica Freeland
nafreeland@debevoise.com

Chen Xu
cxu@debevoise.com

WASHINGTON, D.C.

Satish M. Kini
smkini@debevoise.com

Exhibit 1

Proposed Changes to Compliance Program Requirements

The chart below illustrates how the Proposal would tailor the Volcker Rule's compliance program requirements using a three-tiered approach based on trading activity levels.

Compliance Requirement	Significant Trading Assets and Liabilities	Moderate Trading Assets and Liabilities	Limited Trading Assets and Liabilities
General compliance program requirement	✔[1]	✔	✘
Six-pillars compliance program	✔	✘	✘
Simplified compliance program	✘	✔	✘
Rebuttable presumption of compliance	✘	✘	✔
CEO attestation	✔	✔	✘
Metrics reporting (revised Appendix A) and additional documentation for covered funds	✔	✘	✘
Appendix B – Enhanced Minimum Standards[2]	✘	✘	✘
Reservation of authority[3]	**N/A**	✔	✔

[1] Separate compliance requirements apply for underwriting, market-making related activities, and risk-mitigating hedging exemptions.

[2] The Proposal would eliminate Appendix B. Nevertheless, the Proposal seems to suggest that banking entities with significant or moderate trading assets and liabilities would be required to incorporate elements of Appendix B's requirements into their compliance programs.

[3] A banking entity may be required to apply a more comprehensive compliance program if deemed appropriate by the relevant Agency given the size and complexity of its activities.