

Volcker Rule 2.0: A Detailed Summary of Final Rule Round 1

September 16, 2019

On Tuesday, August 20, 2019, the Federal Deposit Insurance Corporation and the Comptroller of the Currency approved revisions (the “2019 Final Rule”) to the regulations implementing section 13 of the Bank Holding Company Act, commonly referred to as the “Volcker Rule.” The Board of Governors of the Federal Reserve System, Securities and Exchange Commission and Commodity Futures Trading Commission also are expected to approve the revisions.

The 2019 Final Rule follows a July 17, 2018 proposal (the “2018 Proposal”), which was the subject of significant criticism throughout the comment process.¹ According to FDIC Chair Jelena McWilliams, the 2019 Final Rule is intended to “provide more clarity, certainty, and objectivity around the Volcker Rule, while tailoring the requirements to focus on those banks that conduct the overwhelming majority of trades.”² As described below, the 2019 Final Rule indeed appears to address many of the concerns raised by commenters, including by expanding exclusions to and exemptions from the proprietary trading prohibition, removing the proposed “accounting prong” and streamlining metrics reporting requirements. The agencies also adopted without change certain revisions to the covered funds provisions contemplated by the 2018 Proposal, although the bulk of the issues pertaining to covered funds will be the subject of a future proposed rulemaking. Finally, the 2019 Final Rule substantially tailors the compliance program requirements based on the size of an institution’s trading operations, which builds on relief recently granted pursuant to the Economic Growth, Regulatory Relief, and Consumer Protection Act.³

Below is a summary of the most significant changes contemplated by the 2019 Final Rule.⁴ For reference, a redline showing the changes to the regulatory text is available [here](#), and a redline showing the changes to the 2018 Proposal is available [here](#).

¹ For more information regarding the 2018 Proposal please see our related analysis, available [here](#).

² Statement by Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation (Aug. 20, 2019), available [here](#).

³ For more information regarding the implementation of Volcker-related provisions of the Economic Growth, Regulatory Relief, and Consumer Protection Act please see our related analysis, available [here](#).

⁴ For a higher level summary of the 2019 Final Rule please see our prior analysis, available [here](#).

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Proprietary Trading

Revisions to the Definitions of “Trading Account” and “Trading Desk”

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.” Under both the 2013 regulations implementing the Volcker Rule (the “2013 Final Rule”) and the 2019 Final Rule, the term “trading account” is defined using a three-prong test. The first prong (the “short-term intent prong”) includes any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of: (i) short-term resale; (ii) benefitting from actual or expected short-term price movements; (iii) realizing short-term arbitrage profits; or (iv) hedging any of the foregoing. Under the 2013 Final Rule, the short-term intent prong was subject to a rebuttable presumption that a purchase or sale of a financial

instrument was for the trading account if the banking entity held the financial instrument for fewer than 60 days or substantially transferred the risk of the position within 60 days of the purchase or sale.

The second prong (the “market risk capital prong”) applies to the purchase or sale of financial instruments that are both “covered positions” and “trading positions” (or hedges of other covered positions) under the federal banking agencies’ market risk capital rule. The third prong (the “dealer 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 2019 Final Rule retains the short-term intent prong but reverses its rebuttable presumption—a purchase or sale of a financial instrument is presumed not to be for the trading account if the banking entity holds the financial instrument for 60 days or longer, as long as the banking entity does not transfer substantially all of the risk of the position within 60 days of the purchase or sale. The agencies stated that the previous rebuttable presumption had captured many activities that should not have been included in the definition of proprietary trading, such as a foreign branch of a U.S. banking entity purchasing a foreign sovereign debt obligation with a remaining maturity of fewer than 60 days to meet foreign regulatory requirements.

Notably, the agencies declined to adopt the much-criticized proposed accounting prong in lieu of the short-term intent prong, which would have provided that a trading account included any account used by a banking entity to purchase or sell one or more financial instruments recorded at fair value on a recurring basis under applicable accounting standards. In so doing, the agencies agreed with commenters that the accounting prong would have inappropriately scoped in many activities that the Volcker Rule was not intended to address.

The 2013 Final Rule applied the market risk capital prong to a banking entity if any affiliate were subject to the market risk capital rule. In contrast, the 2019 Final Rule applies the market risk capital prong to a banking entity if it, or any affiliate with which the banking entity is consolidated for regulatory reporting purposes, calculates risk-based capital ratios under the market risk capital rule. To explain the change, the agencies provide as an example a broker-dealer that is not consolidated with its parent bank holding company, where the trading positions of such broker-dealer are not included in the holding company’s trading positions in its Form FR Y-9C. Under the 2019 Final Rule, even though the broker-dealer is affiliated with an entity (the parent bank holding company) that calculates risk-based capital ratios under the market risk

capital rule, the broker-dealer would not be subject to the market risk capital prong because the broker-dealer is not consolidated with the parent for regulatory reporting purposes. As a result, the broker-dealer would be required to apply the short-term intent prong and, where applicable, the dealer prong, or may elect to opt-in to apply the market risk capital prong, as described below.

In response to comments that the short-term intent prong and market risk capital prong were largely redundant, the 2019 Final Rule provides that banking entities subject to the market risk capital prong are no longer subject to the short-term intent prong. The agencies declined to adopt a proposed revision to the market risk capital rule that would have incorporated foreign market risk capital frameworks.

In addition, banking entities that are not subject to the market risk capital prong may instead elect to apply it in lieu of the short-term intent prong. Such an election must be made with respect to a banking entity and all of its wholly owned subsidiaries; however, the relevant agency may subject a banking entity affiliate that is not a wholly owned subsidiary to consistent treatment if the agency determines it is necessary to prevent evasion, pursuant to notice and response procedures that are applicable to other aspects of the rule as well. The 2019 Final Rule provides a one-year transition period for banking entities that comply with the short-term intent prong that subsequently become subject to the market risk capital prong.

The 2019 Final Rule does not make changes to the dealer prong, but the agencies reaffirmed that the dealer prong does not capture activities conducted by a dealer that do not require the banking entity to be registered as such. For example, a purchase of securities by a banking entity purely for investment purposes (*i.e.*, not rendering the banking entity a “dealer” under section 3(a)(5) of the Securities Exchange Act of 1934) would not be “for the trading account” under the dealer prong.

The 2019 Final Rule also does not include a proposed reservation of authority, which would have allowed the agencies to determine, on a case-by-case basis, whether certain purchases and sales are for the trading account. Because the 2019 Final Rule does not include the proposed accounting prong and instead retains a short-term intent prong that largely tracks the statutory definition, the agencies did not find it necessary to include a reservation of authority.

Trading Desk

Under the 2013 Final Rule, “trading desk” was 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.” Consistent with the 2018 Proposal, the agencies revised this definition by introducing a multi-factor definition that seeks to align the definition of trading desk with the criteria used to establish

trading desks for other operational, management and compliance purposes. In addition, the revised definition includes a second prong that requires banking entities subject to the market risk capital rule (or that are consolidated affiliates for regulatory reporting purposes of a banking entity subject to the market risk capital rule) to adopt the same delineation of trading desks for purposes of the Volcker Rule as they adopt under the market risk capital rule. Although the current market risk capital rule does not include a definition of “trading desk,” the federal banking agencies indicated that they are expected to implement the Basel Committee on Banking Supervision’s revised market risk capital standards, which include such a definition.

Exclusions from the Definition of Proprietary Trading

Liquidity Risk Management

The 2013 Final Rule excluded 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. Notably, the liquidity management exclusion was limited to purchases or sales of securities and excluded other financial instruments commonly used for liquidity management, including foreign exchange products. The 2019 Final Rule expands this aspect of the liquidity risk management exclusion to include certain foreign exchange forwards and swaps (as defined in the Commodity Exchange Act) and cross-currency swaps, including physically settled and non-deliverable (cash-settled) cross-currency swaps. The agencies note that foreign branches and subsidiaries of U.S. banking entities subject to foreign liquidity requirements may rely on the liquidity management exclusion when trading foreign exchange products to manage currency risk arising from holding liquid assets in foreign currencies. The agencies declined, however, to further expand the liquidity management exclusion as requested by certain commenters and retained the requirement to have a documented liquidity management plan.

Error Trades

The 2019 Final Rule finalizes a substantially similar proposed exclusion for error trades and correcting transactions, *i.e.*, transactions that would otherwise be proprietary trading but are entered into to correct trading errors in the course of conducting a permitted or excluded activity or a subsequent correction related to such a trade. The agencies included this exclusion for clarity even though the 2019 Final Rule reverses the 60-day rebuttable presumption that previously might have captured an error trade. In response to comments, the final exclusion departs from the 2018 Proposal by not requiring a banking entity to transfer erroneously purchased or sold financial instruments to a separately managed trade error account for disposition. The agencies also declined to adopt certain reporting, auditing and testing requirements that were suggested by certain commenters. The agencies emphasize they will monitor this

exclusion for evasion, noting that the magnitude or frequency of errors could indicate trading activity is inconsistent with the exclusion.

Customer-Driven Matched Derivatives Transactions

The 2019 Final Rule adds an exclusion for customer-driven swaps and security-based swaps and matching trades if: (i) matched transactions are entered into contemporaneously; (ii) the banking entity retains no more than minimal price risk; and (iii) the banking entity is not a registered dealer, swap dealer or security-based swap dealer. Further, the preamble states that the exclusion is available only where one of the two matched swaps is entered into for a customer's "valid and independent business purposes." This new exclusion includes not only loan-related swaps commonly entered into by banking entities in connection with a loan but also a wide range of other customer-driven matched derivatives activities. Under the 2013 Final Rule, trading now covered by this exclusion often would have triggered the short-term intent prong's rebuttable presumption and would have been required to meet the requirements for the market making-related activities or risk-mitigating hedging or other exemption.

For example, if a banking entity made a floating rate loan denominated in USD to a European borrower and the customer desired fixed rate exposure to Euros, the banking entity could enter into a floating-to-fixed interest rate swap to provide the fixed rate exposure and a USD-EUR currency swap to provide the EUR exposure, in each case in reliance on the new exclusion, provided that the banking entity simultaneously entered into a fixed-to-floating rate swap and a EUR-USD currency swap, in each case on the same economic terms. In order to meet the requirement of the exclusion, the offsetting swaps would need to be entered into contemporaneously and must be on the same economic terms; otherwise, the agencies may be concerned that the banking entity could be speculating on short-term price movements.

The agencies believe the exclusion will reduce costs for non-dealer banking entities and avoid disruption to a "common and traditional banking service provided to small and medium-sized businesses."

Hedges of Mortgage Servicing Rights

The 2019 Final Rule introduces an exclusion for purchases and sales of financial instruments to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy. This exclusion is meant to provide parity between banking institutions subject to the short-term intent prong and market risk capital prong, as the market risk capital rule explicitly excludes intangibles, including servicing assets, from the definition of "covered position."

Non-trading Assets or Liabilities

The 2019 Final Rule introduces an exclusion for the purchase or sale of a financial instrument that does not meet the definition of “trading asset” or “trading liability” under the applicable reporting form (e.g., Call Report or FR Y-9C) as of January 1, 2020.⁵ The agencies indicated that this exclusion is meant to simplify compliance with the short-term intent prong and more generally provide parity between banking entities subject to the short-term intent prong and those subject to the market risk capital prong.⁶

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 acknowledged that the 2013 Final Rule created significant compliance difficulties with respect to these exemptions due to the extent and complexity of the requirements, particularly with respect to the RENTD requirement. Accordingly, the 2019 Final Rule introduces a presumption of compliance to provide increased certainty regarding whether a trading desk’s activity is designed not to exceed RENTD. Further, the 2019 Final Rule tailors the compliance requirements to a banking entity’s size, complexity and type of activities. Notably, whereas the 2018 Proposal would have required a banking entity relying on the presumption promptly to report limit breaches and increases to the relevant agency, the 2019 Final Rule instead requires banking entities to maintain and make available upon request records of any such breaches or increases and follow certain internal escalation and approval procedures. Importantly, a breach or increase would not necessarily defeat the presumption of compliance, provided that the banking entity takes immediate action to bring the trading desk into compliance and follows certain established internal procedures.

Under the 2019 Final Rule, a banking entity is presumed to comply with the RENTD requirement if it establishes, implements, maintains and enforces the internal limits for each relevant trading desk. For underwriting activities, a banking entity’s internal RENTD limits must be based on three factors: (i) the amount, types and risk of its underwriting position; (ii) the level of exposures to relevant risk factors arising from its

⁵ The agencies specified an “as-of” date in anticipation of potential changes to reporting forms that materially change how “trading assets” and “trading liabilities” are reported.

⁶ Under the market risk capital rule, the term “covered position” is defined to include trading assets and trading liabilities as reported on the relevant regulatory reporting form that meet certain additional conditions. The only positions not required to be reportable as trading assets and trading liabilities are certain foreign exchange and commodities positions. Therefore, by construction, most trading covered by the market risk capital prong is reportable as a trading asset or liability under an applicable reporting form.

underwriting position; and (iii) the period of time that a financial instrument may be held.

For market making-related activities, a banking entity's internal RENTD limits must be based on four factors: (i) the amount, types and risks of its market-maker positions; (ii) the amount, types and risks of the products, instruments and exposures that the trading desk may use for risk management purposes; (iii) the level of exposures to relevant risk factors arising from its financial exposure; and (iv) the period of time that a financial instrument may be held. Although these factors also were used in the 2013 Final Rule, the 2019 Final Rule dispenses with a requirement that the RENTD limit for market-making purposes be based on a "demonstrable analysis of historical customer demand." Notably, the agencies emphasized that although RENTD limits were required to take into account certain factors, including "the liquidity, maturity, and depth of the market for the relevant types of financial instruments," overall, the amended approach is "intended to provide banking entities with the flexibility to determine appropriate limits for market-making related activities." The agencies in particular emphasize that certain factors may not be effective for market-making in derivatives, acknowledging that having "limits on market maker-inventory is generally unworkable in the context of derivatives," and have revised this exemption so that banking entities may "establish limits based on specific conditions that would need to be satisfied in order to utilize the presumption of compliance, rather than a fixed number of market-maker positions."

The 2019 Final Rule also modifies the 2013 Final Rule's generally applicable compliance requirements for the underwriting and market-making exemptions, adopting a tiered approach. In consideration of the complexity of these exemptions and the fact that substantially all trading assets and liabilities are held by the largest firms, the agencies decided only to require banking entities with significant trading assets and liabilities to implement exemption-specific compliance programs. These banking entities must maintain an internal compliance program addressing, in addition to the 2013 Final Rule's requirements, trading desk RENTD limits, written authorization procedures for limit breaches and internal controls and ongoing monitoring of trading desk compliance with its limits.

In response to comments, the agencies confirmed that a banking entity may treat affiliate desks as "clients, customers or counterparties" for purposes of these exemptions, but clarified that banking entities generally may not treat such desks as "clients, customers or counterparties" for purposes of determining a trading desk's RENTD.

Permitted Risk-Mitigating Hedging

The 2013 Final Rule provided 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. In response to industry comments that the requirements to conduct “correlation analysis” and to show that risk-mitigating hedging activity “demonstrably reduces or otherwise significantly mitigates” specific risks were too onerous, the 2019 Final Rule gives banking entities additional flexibility. In particular, banking entities with significant trading assets and liabilities now may justify their reliance on the exemption using any type of analysis and independent testing designed to ensure that risk-mitigating hedging activities are reasonably expected to reduce or otherwise significantly mitigate specific risks to the banking entity; other banking entities no longer must undertake this analysis to justify their reliance on the exemption. Further, the 2019 Final Rule removes language requiring that banking entities show risk-mitigating hedging activities “demonstrably” reduce or otherwise significantly mitigate specific risk, instead merely requiring that hedging activity be reasonably expected to reduce such risk. For all banking entities, however, hedging activities still must be subject to ongoing recalibration to ensure compliance with the exemption.

The 2019 Final Rule also tailors compliance requirements to a banking entity’s trading activities. These changes are most favorable for banking entities without significant trading assets and liabilities. For these firms, the 2019 Final Rule eliminates the requirements for a separate internal compliance program for risk-mitigating hedging, limits on compensation arrangements for persons performing risk-mitigating activities and documentation requirements for certain risk-mitigating activities.

For banking entities with significant trading assets and liabilities, compliance requirements also are streamlined, but to a lesser extent. These firms still will be required to comply with enhanced documentation requirements regarding their cross-desk and aggregated hedges. However, the 2019 Final Rule adds an exception to the enhanced documentation requirements for financial instruments identified on a written list of pre-approved financial instruments commonly used by the trading desk for the specific type of hedging activity at issue, as long as the hedging activity complies with appropriate written, pre-approved limits for that trading desk at the time a financial instrument is purchased or sold. Banking entities with less than significant trading assets and liabilities will not be required to comply with these enhanced documentation requirements at all.

Trading Outside of the United States (“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 2013 Final Rule included several conditions to use of the TOTUS exemption. Of particular note, a foreign banking entity’s U.S.-based personnel were prohibited from “arranging,

negotiating or executing” (referred to as “own ANE”) a transaction that was made in reliance on TOTUS. Second, transactions were prohibited if they were made “with or through” any U.S. entity. The so-called “with or through prohibition” was subject to various exemptions, including one for transactions with the foreign operations of a U.S. entity if no U.S.-based personnel of such U.S. entity were involved in the “arrangement, negotiation or execution” of the transaction (referred to as “counterparty ANE”).

The 2019 Final Rule eliminates various of these conditions, including the own ANE and counterparty ANE limitations, refocusing the TOTUS exemption on where decisions are made as compared to where personnel who are engaged in arranging and negotiating transactions are based. In particular, a foreign banking entity may trade in reliance on TOTUS so long as: (1) the trade (and any related hedge) is not booked to or accounted for by a U.S. branch or affiliate and (2) the banking entity (and any relevant personnel) that makes the decision to trade is not located in the United States. The 2019 Final Rule therefore also eliminates the 2013 Final Rule’s requirement that no financing for the banking entity’s purchases or sales is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under U.S. law. Further, the agencies confirmed that the TOTUS exemption does not preclude a foreign banking entity from engaging a non-affiliated U.S. investment adviser so long as the actions and decisions of the banking entity as principal occur outside of the United States. These modifications 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

In general, the agencies adopted without change covered funds provisions for which rule text had been proposed in the 2018 Proposal. Many issues, however, including possible revisions to the definition of “covered fund,” “banking entity” status questions, and changes to “Super 23A,” are expected to be addressed in a future proposed rulemaking.

Permitted Underwriting and Market Making-Related Activities

The 2013 Final Rule provided an exemption to the covered fund prohibition for underwriting or market-making in covered fund ownership interests provided that certain conditions were satisfied. One such condition required the banking entity to incorporate the aggregate value of all ownership interests of a third-party covered fund in its aggregate 3% of tier 1 capital limit and capital deduction requirement. Under the 2019 Final Rule, banking entities no longer are required to include the value of ownership interests in third-party covered funds held as underwriting or market-

making positions for purposes of the 3% aggregate limit and capital deduction requirement. See Table 1 below. The agencies made this change to align more closely the requirements for underwriting or market-making in covered funds interests with the requirements for engaging in these activities with respect to other financial instruments and to mitigate compliance challenges with the 2013 Final Rule’s exemption. A third-party covered fund for this purpose is one that the banking entity does not sponsor, advise or acquire or retain an ownership interest in pursuant to the asset management exemption or the asset-backed securities issuer exemption. Under the 2019 Final Rule, directly or indirectly guaranteeing, assuming or otherwise insuring the obligations or performance of the covered fund (or any covered fund in which such fund invests) would no longer require the banking entity to treat the covered fund as a “related” (not third-party) covered fund for purposes of this exemption.

In response to comments, the agencies note they will continue to consider whether the approach adopted in the 2019 Final Rule for third-party covered funds should be extended to other covered funds, such as advised funds, and intend to address this issue in a future covered funds proposal. The agencies also will consider comments made regarding the treatment of parallel covered fund investments under the rule.

Table 1

	Third-Party Covered Funds	“Related” Covered Funds
2013 Final Rule	<ul style="list-style-type: none"> • Aggregate 3% limit • Capital deduction 	<ul style="list-style-type: none"> • Aggregate 3% limit • Capital deduction • Per-fund 3% limit
2019 Final Rule	<ul style="list-style-type: none"> • None 	<ul style="list-style-type: none"> • Aggregate 3% limit • Capital deduction • Per-fund 3% limit

Permitted Risk-Mitigating Hedging

When finalizing the 2013 Final Rule, the agencies permitted only hedging activities involving ownership interests in covered funds for hedging of certain employee compensation arrangements and declined to adopt a broader hedging exemption to facilitate customer-facing activity. Now, under the 2019 Final Rule, banking entities are permitted to acquire or retain an ownership interest in a covered fund as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate exposure by the customer to the profits and losses of the covered fund. As a result, banking entities are permitted to hold covered fund interests to hedge fund-linked products. In contrast to statements made when adopting the 2013 Final Rule, the agencies state that they do not believe that this type of hedging activity “necessarily” constitutes a high-risk trading strategy that could threaten the safety and soundness of

the banking entity (any activity that meets this standard should be permitted under the so-called prudential backstops). The agencies caution, however, that the exemption is meant only for customer-driven transactions; a banking entity cannot rely on this exemption to solicit customer transactions to facilitate the banking entity's own exposure to a covered fund. Finally, the 2019 Final Rule also adopts the same amendments to align this exemption with the revised proprietary trading hedging exemption by eliminating the requirement that a risk-mitigating hedging transaction "demonstrably" reduce or otherwise significantly mitigate the relevant risks.

Solely Outside the United States ("SOTUS") Fund Exemption

Foreign banking entities benefit from an exemption to the covered funds prohibition for covered fund investments and sponsorship that occurs "solely outside of the United States" (the "SOTUS" exemption). Just as for the TOTUS exemption, the 2019 Final Rule removes the condition that had prohibited a U.S. branch or affiliate from providing financing for the foreign banking entity's ownership or sponsorship under the SOTUS exemption. The agencies also similarly clarify that the SOTUS exemption does not preclude a foreign banking entity from engaging a non-affiliated U.S. investment adviser as long as the actions and decisions of the banking entity as principal occur outside of the United States.

The 2019 Final Rule also codifies the marketing restriction guidance of FAQ No. 13, which provides that the SOTUS exemption 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. Consistent with FAQ No. 13, if the foreign banking entity sponsors or advises a covered fund, then the foreign banking entity would be deemed to participate in any offer or sale of the covered fund ownership interests for purposes of this exemption.

Super 23A Prime Brokerage Exemption

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. The Super 23A provisions in the 2013 Final Rule included 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 2019 Final Rule codifies staff FAQ No. 18 by providing that a banking entity must provide the CEO certification annually no later than March 31 of

each year. The agencies expect to address other issues regarding the prime brokerage exemption and Super 23A more generally in a separate covered funds proposal.

Status of Registered Funds and Foreign Excluded Funds

As noted above, covered funds issues generally will be addressed in a future rulemaking. In the meantime, the agencies have stated that they are not modifying or revoking any previously issued staff FAQs or guidance related to the banking entity status and seeding of registered investment companies, foreign public funds and foreign excluded funds. Further, the agencies did not revise the statement emphasized in the 2018 Proposal that FAQ No. 16 does not set “any maximum prescribed period for a RIC or PPF seeding period.”

Compliance Date and Program Requirements

Compliance Date

The 2019 Final Rule is effective on January 1, 2020, with a mandatory compliance date of January 1, 2021. Notably, voluntary early compliance is permitted “in whole or in part.” However, with respect to metrics reporting, voluntary early compliance is subject to the agencies’ completion of necessary technical changes. In addition, banking entities will want to have the requisite compliance policies and procedures in place to address the changes in the 2019 Final Rule before early adopting all or part of the rule.

Compliance Tailored by Size

The 2019 Final Rule, like the 2018 Proposal, establishes three tiers of banking entities, based on dollar amount of trading assets and liabilities (excluding financial instruments that are obligations of or guaranteed by the United States or its agencies, as well as certain U.S. government owned or sponsored enterprises such as Ginnie Mae, Fannie Mae, Freddie Mac, a FHLB, Farmer Mac or a Farm Credit system bank),⁷ with each subject to differing compliance obligations which are summarized in Exhibit 1. Trading assets and liabilities are measured on a worldwide consolidated basis for U.S. banking entities and, in a departure from the 2018 Proposal, using combined U.S. operations for foreign banking organizations (including all subsidiaries, affiliates, branches and agencies of the foreign banking organization operating, located or organized in the United States, non-U.S. branches that are managed or controlled by a U.S. branch or agency of the foreign banking entity, as well as foreign operations of U.S. agencies, branches or subsidiaries of a foreign banking organization).

⁷ The 2018 Proposal only would have excluded U.S. government and agency trading assets and liabilities and not U.S. government owned or sponsored enterprise assets and liabilities.

- *Significant trading assets and liabilities:* \geq \$20 billion (increased from \$10 billion under the 2018 Proposal). These banking entities are subject to the most stringent compliance requirements, including the six-pillar compliance program and CEO attestation. The agencies estimate that banking entities in this category would hold approximately 93 percent of the trading assets and liabilities in the U.S. banking system.
- *Moderate trading assets and liabilities:* \geq \$1 billion but $<$ \$20 billion. These banking entities are permitted to implement a simplified compliance program that references the statutory requirements in existing policies, procedures and compliance programs. Further, they are not subject to the CEO attestation requirement. The agencies estimate that banking entities in this category together with those in the category for significant trading assets and liabilities would hold approximately 99 percent of the trading assets and liabilities in the U.S. banking system.
- *Limited trading assets and liabilities:* $<$ \$1 billion. These banking entities benefit from a rebuttable presumption of compliance, and also are not subject to the CEO attestation requirement. The agencies note in the preamble, however, that banking entities in this category are not relieved from their “obligation to comply with the prohibitions and other requirements of the permitted trading activity exemptions, to the extent that the banking entity engages in such activities,” and such banking entities may consider, for example, integrating the requirements for relevant permitted trading activities into existing internal policies and procedures.

The 2019 Final Rule also includes a reservation of authority that allows the agencies to treat a banking entity with limited or moderate trading assets and liabilities as being subject to a higher compliance tier upon following certain notice and response procedures. Further, as proposed, the 2019 Final Rule eliminates “Appendix B,” which outlined “Enhanced Minimum Standards” for compliance. The agencies note that the requirements are unnecessarily duplicative of the six-pillar compliance program and state that banking entities could integrate the Volcker Rule’s compliance requirements into their existing compliance programs.

Quantitative Metrics

The 2019 Final Rule makes a number of changes to the reporting and recordkeeping requirements applicable to banking entities with significant trading assets and liabilities; these changes are summarized in Exhibit 2. Although the revisions introduce new metrics, others have been eliminated or replaced and overall the agencies estimate that the revised metrics in the 2019 Final Rule will result in a 67 percent reduction in the number of data items and an approximately 94 percent reduction in the total volume of data relative to the 2013 Final Rule’s reporting requirement. Moreover, the agencies

expect that banking entities largely will be able to leverage data already collected in the regular course of business as well as for market risk capital programs to satisfy their Volcker Rule quantitative reporting requirements.

Trading Desk Information

The 2019 Final Rule requires banking entities to submit the following descriptive information for each trading desk: (i) trading desk name and unique identification label; (ii) each type of covered trading activity in which the trading desk is engaged; (iii) brief description of the trading desk's general strategy; (iv) each agency receiving the submission for the desk; and (v) the exemptions or exclusions under which the desk conducts its trading activity. The 2019 Final Rule also requires banking entities to identify each calendar day that serves as a trading day for a trading desk, including days when U.S. markets are closed but non-U.S. locations are open, and the currency and the conversion rate for any metrics calculated in currencies other than U.S. dollars. Banking entities have the option to provide additional narrative statements to supplement their submissions.

Information Schedules

The 2019 Final Rule introduces an "Internal Limits Information Schedule" and a "Risk Factor Attribution Information Schedule" that provide identifying and descriptive information relevant to the new "Internal Limits and Usage" and "Comprehensive Profit and Loss Attribution" metrics, respectively.

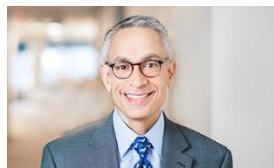
Timing

The 2019 Final Rule reduces the frequency of required metrics reports from monthly to quarterly, to be submitted within 30 calendar days of quarter-end.

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Please do not hesitate to contact us with any questions.

WASHINGTON, D.C.

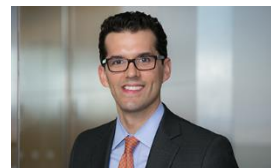


Satish M. Kini
smkini@debevoise.com

NEW YORK



Gregory J. Lyons
gjlyons@debevoise.com



David L. Portilla
dlportilla@debevoise.com



Alison M. Hashmall
ahashmall@debevoise.com



Andrew Field
alfield@debevoise.com



Chen Xu
cxu@debevoise.com

Exhibit 1

Changes to Compliance Program Requirements

The chart below illustrates how the 2019 Final Rule tailors 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 2019 Final Rule eliminated Appendix B.

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. That agency will exercise such authority in accordance with notice and response procedures giving banking entities an opportunity to rebut heightened compliance requirements.

Exhibit 2

Changes to Metrics Reporting Requirements

The chart below illustrates how the 2019 Final Rule modifies the Volcker Rule’s metrics reporting requirements for banking entities with significant trading assets and liabilities. Each retained metric will be reported quarterly for every trading day.

2013 Final Rule Metric	2019 Final Rule Status	Applicability	Reporting Requirement
Risk and Position Limits and Usage	Replaced with “Internal Limits and Usage” metric	Trading desks engaging in covered trading activity	The constraints that define the amount of risk and the positions that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk, as well as the value of usage of the limit
Risk Factor Sensitivities	Eliminated	—	—
Value-at-risk	Retained	Trading desks engaging in covered trading activity	The risk of future financial loss in the value of a trading desk’s aggregated positions at the 99% confidence level based on current market conditions
Stressed value-at-risk	Eliminated	—	—
Comprehensive Profit and Loss Attribution	Retained	Trading desks engaging in covered trading activity	An analysis that attributes the daily fluctuation in the value of a trading desk’s positions to various sources
Inventory Turnover	Replaced with “Positions” metric	Trading desks relying on underwriting or market-making exemptions	The value of securities and derivatives positions managed by the trading desk
Inventory Aging	Eliminated	—	—
Customer-facing Trade Ratio	Replaced with “Transaction Volume” metric	Trading desks relying on underwriting or market-making exemptions	The value and number of securities and derivatives transactions conducted by the trading desk with certain counterparty categories