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| **DATE:** | January 10, 2014 |
| **MEMORANDUM TO:** | Board of Directors |
| **FROM:** | Doreen R. Eberley, Director<br>Division of Risk Management Supervision |
| **SUBJECT:** | Interim Final Rule Authorizing a Permitted Activity Exemption for Certain Collateralized Debt Obligations from the Interagency Final Rule on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds |

**Recommendation:** Staff recommends that the FDIC Board approve the attached interagency Interim Final Rule that would provide a permitted activity exemption for certain collateralized debt obligations regarding the exclusion from the definition of "covered fund" under the final rule to implement section 13 of the Bank Holding Company Act ("BHC Act"),[1] as enacted by section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

**Summary:** Section 619 of the Dodd-Frank Act generally prohibits banking entities from engaging in proprietary trading and from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund. These prohibitions are subject to a number of statutory exemptions, restrictions and definitions.

The Board of Governors of the Federal Reserve System ("FRB"), the Office of the Comptroller of the Currency ("OCC"), the FDIC, the Commodity Futures Trading Commission ("CFTC"), and the Securities and Exchange Commission ("SEC") (collectively, the "Agencies") have responsibilities for implementing section 619 through rulemaking. These Agencies issued a final rule implementing section 619,[2] which becomes effective on April 1, 2014 ("Final Rule"). The Final Rule contains critical definitions and descriptions of permissible and impermissible activities and requires implementation of a comprehensive compliance program to ensure that

[1] See 12 U.S.C. 1851.

[2] These final rules will be codified at 12 CFR part 44 (OCC), 12 CFR part 248 (FRB), 12 CFR part 351 (FDIC), 17 CFR part 75 (CFTC), and 17 CFR part 255 (SEC).

impermissible activities do not take place. In particular, the Final Rule requires that a banking entity engaged in covered activities or investments establish a variety of limits, written policies, internal review processes and controls related to its market-making, underwriting and hedging activities; and restructure and limit certain of its investments in and relationships with covered funds, including securitizations of non-loan assets.

The Agencies have received requests from the various bank holding companies, banks and other interested parties for an exemption for certain collateralized debt obligations backed by trust preferred securities ("TruPS CDOs") from the prohibition in section __.10(a)(1) of the Final Rule covering banking entities' acquisition or retention of any ownership interest in or sponsor of a hedge fund or private equity fund as defined in section 13(h)(2) of the BHC Act and defined as a covered fund under section __.10(b) of the Final Rule ("Covered Fund"). Certain of these requests from banking entities and financial services trade associations cited the need for consistency between the implementation of section 619 of the Dodd-Frank Act and the capital treatment of TruPS in section 171 of the Dodd-Frank Act. Section 171(d)(4)(B) of the Dodd-Frank Act generally provides that TruPS issued by depository institution holding companies shall be phased-out of such companies' calculation of regulatory capital for purposes of determining Tier 1 capital. However, section 171(d)(4)(C) further provides for the grandfathering of TruPS issued before May 19, 2010 by certain depository institution holding companies with total consolidated assets of less than $15 billion as of December 31, 2009, and mutual holding companies established as of May 19, 2010.[3]

The Agencies recently have issued guidance regarding issues involved in the implementation of the Final Rule to ownership interests by banking entities in TruPS CDOs.[4]

After further review and analysis, the Agencies have determined that it likely would have been infeasible for smaller depository institution holding companies to issue TruPS directly to

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[3] See 12 U.S.C. 5371(d)(4)(B) and (C).

[4] See FAQ Regarding Collateralized Debt Obligations Backed by Trust Preferred Securities under the Final Volcker Rule (December 19, 2013). See also Statement regarding Treatment of Certain Collateralized Debt Obligations Backed by Trust Preferred Securities under the Rules implementing Section 619 of the Dodd-Frank Act (December 27, 2013).

investors. Accordingly, the issuance of TruPS using the pool structure of a TruPS CDO was a feasible and important way for such institutions to avail themselves of TruPS for regulatory capital purposes. The TruPS CDO structure was the pooled investment vehicle that gave effect to the use of TruPS as a regulatory capital instrument prior to May 19, 2010, and was part of the status quo that Congress sought to preserve with the grandfathering provision of section 171. As such, the Agencies have determined that in order to effect the full grandfathering of TruPS provided for under section 171(b)(4)(C) of the Dodd-Frank Act, it is necessary to exempt certain TruPS CDOs from the prohibition on certain ownership interests by banking entities in Covered Funds under section __.10(a)(1)(B) of the Final Rule. As such, the Agencies have determined that this exemption is consistent with the purposes of section 13 of the BHC Act.

For the reasons provided in the attached Interim Final Rule, and consistent with section 171 of the Dodd-Frank Act (setting for generally applicable capital requirements), the Agencies have decided to exempt from the prohibition on the acquisition or retention of any ownership interest in or sponsor of certain Covered Funds by banking entities, only if:

(i) the issuer was established before May 19, 2010;

(ii) the banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral (as defined below); and

(iii) the banking entity's interest in the vehicle was acquired on or before December 10, 2013 (unless acquired pursuant to a merger or acquisition).

Under the Interim Final Rule, a "Qualifying TruPS Collateral" is defined by reference to the standards in section 171(b)(4)(C) to mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, for any reporting period during the 12 months immediately preceding the issuance of such 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 Interim Final Rule also provides clarification that the relief relating to these TruPS CDOs also extends to activities of banking entity as a sponsor for these securitization vehicles since acting as a sponsor might otherwise be subject to the prohibitions or requirements of section 619 of the Dodd-Frank Act.

To minimize the burden of applying the Interim Final Rule, the FRB, the FDIC, and the OCC (collectively, the "Federal banking agencies") will make public a non-exclusive list of issuers that meet the requirements of the Interim Final Rule. A banking entity may rely on the list published by the Federal banking agencies.

The Agencies have required that an issuer must have invested primarily in Qualifying TruPS Collateral to meet the requirements of the Interim Final Rule; this is intended to distinguish those securitization vehicles that have invested a majority of their offering proceeds in Qualifying TruPS Collateral from other securitization vehicles that have acquired only a modest amount of such investments. The Agencies have included a "reasonable belief" standard since the relevant CDOs were structured and made their investments many years ago and all of the relevant documentation may not be readily available to banking entities. Based on discussions with major market participants involved in structuring and offering TruPS CDOs, the Agencies expect that the Interim Final Rule will cover all of the issuers that were formed for the purpose of investing in TruPS.

For the reasons stated in the Interim Final Rule, the Agencies find good cause to act immediately to adopt this rule on an interim final basis without prior solicitation of comment. With this

Interim Final Rule and request for comment, the Agencies would not be reopening the Final Rule.

**Conclusion:** Staff recommends that the FDIC Board approve the Federal Register publication of the attached Interim Final Rule, with a comment period of 30 days from the date of Federal Register publication and with an effective date of April 1, 2014, to implement section 619 of the Dodd-Frank Act, in a manner consistent with section 171(b)(4)(C) of the Dodd-Frank Act.

**Contacts**

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**Concurrence:**

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