Annual CEO Attestation

Under the final rule, banking entities subject to the enhanced minimum standards for compliance programs under Appendix B of the final rule must provide an annual CEO attestation regarding the banking entity's compliance program. When must the first annual CEO attestation required under Appendix B be provided to the relevant Agency?

Appendix B of the final rule provides that, based on a review by the CEO of the banking entity, the CEO of the banking entity must, annually, attest in writing to the relevant Agency that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under Appendix B and § 351.20 of the final rule in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and the final rule.[1]

As noted in the Board Order extending the conformance period under section 13 of the BHC Act, each banking entity must conform its proprietary trading activities and covered fund activities and investments to the prohibitions and requirements of section 13 and the final rule by no later than the end of the conformance period. As a result, banking entities must meet the compliance program requirements of the final rule by the end of the conformance period, which is currently July 21, 2015.

The CEO attestation under Appendix B of the final rule is an annual requirement. The staffs of the Agencies believe that banking entities subject to Appendix B as of the end of the conformance period should submit the first CEO attestation required under Appendix B after the end of the conformance period but no later than March 31, 2016. A banking entity may provide the required annual attestation in writing at any time prior to the March 31 deadline to the relevant Agency. This allows the CEO time to review the design and operation of the entity's compliance program after the program is fully implemented to ensure it is reasonably designed to achieve compliance with section 13 and the final rule. Banking entities that become subject to Appendix B after the end of the conformance period should submit their first CEO attestation within one year of becoming subject to Appendix B.[2] Thereafter, banking entities should provide the CEO attestation annually within one year of its prior attestation.

[1] 12 CFR Part 351, Appendix B.

[2] For example, a banking entity with between $25 billion and $50 billion in trading assets and liabilities, as described in §§351.20(c)(1) and (d), will be required to implement an enhanced compliance program by April 30, 2016. This banking entity would be required to provide its first CEO attestation to the relevant Agency by April 30, 2017.

Compliance for Market Making and the Identification of Covered Funds

Question: May a banking entity's compliance program for market making-related activities include objective factors on which a trading desk may reasonably rely to determine whether a security is issued by a covered fund? Furthermore, may a market maker meet its compliance program requirements by making use of a shared utility or third party service provider that utilizes objective factors if the market maker reasonably believes the system of the shared utility or third party service provider will identify whether a security is issued by a covered fund?

Answer: The final rule's exemption for market making-related activity requires a banking entity to establish, implement, maintain, and enforce a reasonably designed compliance program for a trading desk engaged in market making-related activity that includes, among other things, strong internal controls and independent testing.[1] For purposes of meeting the final rule's exemption for market-making,[2] a reasonably designed compliance program for a trading desk engaged in market making-related activity may include objective factors on which the trading desk may reasonably rely to determine whether a security is issued by a covered fund. Objective factors are factual criteria that can be used to reliably identify whether an issuer or a particular type of issuer is a covered fund.[3] As an example, an objective factor would include whether the securities of the issuer were offered in transactions registered under the Securities Act.[4] Objective factors would not be considered part of a reasonably designed compliance program if the banking entity designed or used such objective factors to evade section 13 and the final rule.

On the other hand, the Agencies' staffs do not believe it would be reasonable for a trading desk to rely solely on either or both the name of the issuer or the title of the issuer's securities; these factors alone would not convey sufficient information about the issuer for a trading desk reasonably to determine whether a security is issued by a covered fund.

A reasonably designed compliance program for a trading desk engaged in market making-related activity also may permit the trading desk to use a shared utility or third party service provider

---

[1] See § 351.4(b)(2)(iii) of the final rule. See also § 351.20(a) of the final rule (providing that "each banking entity shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and [the final rules]").

[2] § 351.11(c).

[3] Notably, the reasonableness of a particular objective factor may vary based on the type of issuer, and relying on objective factors may not be reasonable for all types of issuers. This may be the case, for example, for potential covered fund issuers whose operations or structure are not consistent with market standards or practices for which objective factors could be tailored.

[4] See 79 FR at 5674 n.1717, 5687 n.1861.

that utilizes objective factors if the banking entity reasonably believes the system of the shared utility or third party service provider will identify whether a security is issued by a covered fund and use of the shared utility or third party service provider is identified in the trading desk's compliance program. The use of objective factors by a shared utility or third party service provider should be evaluated by the banking entity in considering whether the banking entity reasonably believes that the shared utility or third party service provider has a system that will identify whether a security is issued by a covered fund.

Whether a compliance program is reasonably designed will depend on the facts and circumstances. A compliance program that is reasonably designed for a trading desk engaged in market making-related activities may not be reasonably designed for other activities conducted by a banking entity. This FAQ only addresses the compliance program for a trading desk engaged in market making-related activity.[5]

Importantly, the banking entity's reliance on objective factors, a shared utility, or a third party service provider must be subject to independent testing and audit requirements applicable to the banking entity's compliance program.[6] If independent testing or other review of the banking entity's compliance program shows that the objective factors used by the banking entity, shared utility, or third party service provider are not effective in identifying whether a security is issued by a covered fund, then the banking entity must promptly update its compliance program to remedy such issues and, as necessary, take action under § 351.21 of the final rule implementing section 13 of the BHC Act. Further, if at any time the banking entity discovers it holds an ownership interest in a covered fund in violation of the final rule implementing section 13 of the BHC Act, it must promptly dispose of the interest or otherwise conform it to the requirements of the final rule.[7]

[5] In the context of market making-related activity, it generally would not be reasonable for the compliance program to permit the trading desk to rely on objective factors, shared utilities, or third party service providers in determining whether an issuer is a covered fund if the banking entity has already determined that the issuer is a covered fund in connection with sponsoring the issuer or acquiring an ownership interest in the issuer as an investment. Where a banking entity organizes and offers, including sponsors, an entity that may be a covered fund, the banking entity should know if the issuer is a covered fund and may not rely on objective factors. See § 351.11(a)-(b).

[6] See § 351.20(b)(4), Appendix B.

[7] While market making-related activity in covered funds is permitted under § 351.11(c) of the final rule, such activity is subject to certain limits on the amount of covered fund ownership interests the banking entity may hold.

Conformance Period

Question: How do the requirements of section 13 of the BHC Act and the final rule apply to a banking entity during the conformance period? For instance, must a banking entity deduct its investment in a covered fund from its tier 1 capital prior to the end of the conformance period?

Answer: The Board extended the statute's conformance period until July 21, 2015 ("Board Conformance Order").[1] The Board also has issued a statement of policy in which the Board clarified the activities and investments that are permissible during the conformance period.[2]

As explained in the Board Conformance Order, a banking entity must conform all of its proprietary trading activities and covered fund activities and investments to the prohibitions and requirements of section 13 and the final rule by no later than the end of the conformance period. During the conformance period, a banking entity is expected to engage in good-faith efforts, appropriate for its activities and investments that will result in the conformance of all of its activities and investments to the requirements of section 13 and the final rule no later than the end of the conformance period. Good-faith efforts include evaluating the extent to which the banking entity is engaged in activities and investments that are covered by section 13 and the final rule, as well as developing and implementing a conformance plan that is appropriately specific about how the banking entity will fully conform all of its covered activities and investments by the end of the conformance period. In addition, under the Board Conformance Order, banking entities that have stand-alone proprietary trading operations are expected to promptly terminate or divest those operations. Moreover, banking entities should not expand activities and make investments during the conformance period with the expectation that additional time to conform those activities or investments will be granted.

As an example of how the conformance period works in practice, section 13(d)(4) of the BHC Act and § 351.12(d) of the final rule require a banking entity to deduct from the banking entity's tier 1 capital, as determined under § 351.12(c)(2) of the final rule, its permitted investments in all covered funds. A banking entity would not be required to make this deduction until the end of the conformance period, which is currently July 21, 2015. As noted above, a banking entity is expected to engage in good faith efforts during the conformance period so that it can comply with this requirement no later than the end of the conformance period. Notably, as specified in the final rule, certain metrics reporting requirements will be in place before the end of the conformance period for banking entities with $50 billion or greater in trading assets and liabilities.

---

[1] See Board Order Approving Extension of Conformance Period, *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf.

[2] See Statement of Policy Regarding the Conformance Period for Entities Engaged in Proprietary Trading or Private Equity Fund and Hedge Fund Activities, 77 Fed. Reg. 33,949 (June 8, 2012).

The Volcker Rule: Frequently Asked Questions

30-Day Metrics Reporting During the Conformance Period

On what date do banking entities that currently are subject to metrics reporting under Appendix A of the final rule implementing section 13 of the BHC Act need to start reporting metrics within 10 days of the end of each calendar month?

The final rule implementing section 13 of the BHC Act required certain of the largest banking entities to report metrics for July 2014 data beginning in September 2014.[1] In particular, § 351.20(d)(3) of the rule provides that, unless the appropriate Agency notifies the banking entity in writing that it must report on a different basis, banking entities with $50 billion or more in trading assets and liabilities must report the information required by Appendix A for each calendar month within 30 days of the end of the relevant calendar month and beginning with information for the month of January 2015, within 10 days of the end of each calendar month.

The Agencies have received five months of metrics submissions to-date. Several banking entities that currently are subject to metrics reporting have requested that the Agencies maintain the 30-day period for reporting the required metrics through July 2015 (the end of the conformance period for proprietary trading activities). Banking entities have argued that additional time is needed to allow them to implement systems and processes in order to ensure overall data integrity and reliability.

The purpose of the shortened reporting schedule is to allow for more effective supervision of banking entities for compliance with section 13 and the final rule.[2] Staffs of the Agencies believe that, during the period firms are building their compliance programs, delaying the shortened reporting period is consistent with that purpose. Accordingly, banking entities required to report metrics may report such information within 30 days of the end of the relevant calendar month through the report of metrics for the month of July 2015. This means that metrics for the month of July 2015 must be reported within 30 days of the end of the month, or August 31, 2015. Beginning with metrics for the month of August 2015, banking entities must submit metrics within 10 days of the end of the month. As a result, metrics for the month of August 2015 must be reported by September 10, 2015.

---

[1] See 12 CFR 351.20(d)(2). Staffs of the Agencies previously issued an FAQ stating that a banking entity with trading assets and liabilities of at least $50 billion, as calculated under §351.20(d)(1), must begin to measure and record the required metrics on a daily basis starting July 1, 2014 and report its daily metrics recorded during the month of July by September 2, 2014. See http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#1.

[2] See 79 FR at 5765 n.2689.

Metrics Reporting and Confidentiality

Are the quantitative measurements that a banking entity reports under Appendix A of the final rule protected by the Freedom of Information Act ("FOIA")?

The staffs of the Agencies encourage banking entities subject to Appendix A to evaluate exemptions available under the FOIA for their reported metrics information and to request confidential treatment as appropriate. Some firms have stated that metrics data reported to the Agencies represent confidential proprietary information of the banking entity. Exemption 4 of the FOIA protects matters that are trade secrets and commercial or financial information obtained from a person that is privileged or confidential.[1] Other exemptions may also apply. We expect to maintain the confidentiality of the reported metrics information to the extent permitted by law.

[1] 5 U.S.C. § 552(b)(4). The FDIC's FOIA regulation regarding the treatment of confidential commercial information is codified at 12 CFR §309.5(g)(4).

Foreign Public Fund Seeding Vehicles

Question: The final rule excludes from the definition of covered fund a registered investment company and business development company, including an entity that is formed and operated pursuant to a written plan to become one of these entities. Would an entity that is formed and operated pursuant to a written plan to become a foreign public fund receive the same treatment?

Answer: Section 351.10(c)(12) of the final rule explicitly excludes an issuer that is registered as an investment company under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), or that is formed and operated pursuant to a written plan to become a registered investment company ("RIC") in accordance with the banking entity's compliance program as described in § 351.20(e)(3), and that complies with the requirements of section 18 of the Investment Company Act (15 U.S.C. 80a-18).[3] Section 351.10(c)(1) of the final rule also excludes from the definition of covered fund a foreign public fund that is an issuer that is organized or established outside of the United States; is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and sells ownership interests predominantly through one or more public offerings outside of the United States. Foreign public funds that meet these qualifications are therefore treated the same as RICs for purposes of the definition of "covered fund" under the final rule. Although the final rule excludes from the definition of covered fund certain seeding vehicles that will become RICs, as discussed above, the final rule does not address a seeding vehicle that will become a foreign public fund.

Staffs of the Agencies believe that, with respect to determining whether an entity is a covered fund, it would be appropriate that an issuer that will become an excluded foreign public fund be treated during its seeding period the same as an issuer that will become an excluded RIC. Accordingly, staffs of the Agencies do not intend to advise the Agencies to treat as a covered fund under the final rule an issuer that is formed and operated pursuant to a written plan to become a qualifying foreign public fund. Any written plan would be expected to document the banking entity's determination that the seeding vehicle will become a foreign public fund, the period of time during which the vehicle will operate as a seeding vehicle, the banking entity's plan to market the vehicle to third-party investors and convert it into a foreign public fund within the time period specified in § 351.12(a)(2)(i)(B) of subpart C, and the banking entity's plan to operate the seeding vehicle in a manner consistent with the investment strategy, including leverage, of the issuer upon becoming a foreign public fund. For purposes of the definition of covered fund, this would treat an issuer that becomes a qualifying foreign public fund the same as an issuer that becomes a RIC during the seeding period for the fund.

[3] The final rule also explicitly excludes an issuer that has elected to be regulated as a business development company ("BDC") pursuant to section 54(a) of that Act (15 U.S.C. 80a-53) and has not withdrawn its election, or that is formed and operated pursuant to a written plan to become a BDC as described in § 351.20(e)(3) and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a-60).

How does the final rule apply to a foreign public fund sponsored by a banking entity?

The final rule excludes foreign public funds from the definition of covered fund.[1] To qualify for this exclusion, these funds must, among other conditions, be authorized to offer and sell ownership interests to retail investors in the foreign public fund's home jurisdiction and must sell ownership interests predominantly in public offerings outside of the United States.[2] The Agencies stated that this exclusion was "designed to prevent . . . the definition of covered fund from including foreign funds that are similar to U.S. registered investment companies, which are by statute not covered by section 13."[3] The Agencies also stated that the "foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States."[4]

Staffs of the Agencies understand that, unlike in the case of U.S. registered investment companies,[5] sponsors of foreign public funds in some foreign jurisdictions select the majority of the fund's directors or trustees, or otherwise control the fund for purposes of the BHC Act by contract or through a controlled corporate director. These and other corporate governance structures abroad therefore have raised questions regarding whether foreign public funds that are sponsored and distributed outside the U.S. and in accordance with foreign laws are banking entities by virtue of their relationships with a banking entity.

As noted by the Agencies in the preamble to the final rule, the definition of private equity fund and hedge fund in section 619 of the Dodd-Frank Act appears to reflect Congressional concerns regarding less regulated private funds as well as an intention not to disrupt registered investment companies, such

---

[1] See § 351.10(c)(1). The final rule defines the term "covered fund" to include certain funds that rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act; certain commodity pools as defined in section 1a(10) of the Commodity Exchange Act; and certain foreign funds. See § 351.10(b)(1).

[2] See § 351.10(c)(1).

[3] 79 FR at 5673. The Agencies also noted more generally that the exclusions from the covered fund definition were designed, among other purposes, "to address the potential over-breadth of the covered fund definition and related requirements without such exclusions by permitting banking entities to invest in and have other relationships with entities that do not relate to the statutory purpose of section 13." 79 FR at 5677.

[4] 79 FR at 5678. The Agencies explained in the preamble that they "tailored the final definition [of covered fund] to include entities of the type that the Agencies believe Congress intended to capture in its definition of private equity fund and hedge fund in section 13(h)(2) of the BHC Act by reference to section 3(c)(1) and 3(c)(7) of the Investment Company Act. Thus, the final definition focuses on the types of entities formed for the purpose of investing in securities or derivatives for resale or otherwise trading in securities or derivatives, and that are offered and sold in offerings that do not involve a public offering, but typically involve offerings to institutional investors and high-net worth individuals (rather than to retail investors)." 79 FR at 5666.

[5] See 79 FR at 5676 (recognizing that the Federal Reserve Board's regulations and orders have long recognized that a bank holding company may organize, sponsor, and manage a registered investment company, including by serving as investment adviser to the registered investment company, without controlling the registered investment company for purposes of the BHC Act).

as U.S. mutual funds.[6] The final implementing regulations issued by the Agencies adopted the same approach toward foreign public funds in order to make clear that U.S. banking entities and their foreign affiliates, as well as foreign banking organizations, could continue to carry on their traditional asset management businesses involving foreign public funds outside of the United States.[7] The final rule imposes conditions to ensure that the foreign public fund is distributed predominantly through public offerings outside the United States, is offered to retail investors in the issuer's home jurisdiction, is distributed in accordance with all applicable requirements for distributing public funds in the jurisdiction in which the distribution is being made, and includes publicly available offering disclosure documents. These requirements were designed to mirror the characteristics of U.S. mutual funds that are outside the applicability of section 619 of the Dodd-Frank Act.[8]

By referring to characteristics common to publicly distributed foreign funds rather than requiring that foreign public funds organize themselves identically to U.S. mutual funds or other types of U.S. regulated investment companies, the final rule recognized that foreign jurisdictions have established their own frameworks governing the details for the operation and distribution of foreign public funds.

Section 351.12 of the final rule further provides that, for purposes of complying with the covered fund investment limits, a U.S. registered investment company, SEC-regulated business development company, or foreign public fund will not be considered to be an affiliate of the banking entity so long as the banking entity: (i) does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the fund; and (ii) provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with the limitations under applicable regulation, order, or other authority. The staffs of the Agencies note that these limitations would include those imposed by an authority in the relevant foreign jurisdiction.[9]

Staffs of the Agencies would not advise that the activities and investments of a foreign public fund that meets the requirements in section 351.10(c)(1) and section 351.12(b)(1) of the final rule be attributed to

---

[6] See, e.g., 79 FR at 5675 ("Section 13's definition of private equity fund and hedge fund by reference to section 3(c)(1) and 3(c)(7) of the Investment Company Act appears to reflect Congress' concerns about banking entities' exposure to and relationships with investment funds that explicitly are *excluded* from SEC regulation as investment companies."). (emphasis in original) See also e.g., 79 FR at 5666.

[7] 79 FR at 5678 (stating "the Agencies' view that the foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States").

[8] 79 FR at 5678.

[9] See § 351.12(b)(1)(ii). See also 79 FR at 5732 ("[F]or purposes of section 13 of the BHC Act and the final rule, a registered investment company, SEC-regulated business development company, and a foreign public fund as described in §__.10(c)(1) of the final rule will not be considered to be an affiliate of the banking entity if the banking entity owns, controls, or holds with the power to vote less than 25 percent of the voting shares of the company or fund, and provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund only in a manner that complies with other limitations under applicable regulation, order, or other authority.")

the banking entity for purposes of section 619 of the Dodd-Frank Act or the final rule where, consistent with section 351.12(b)(1) of the final rule, the banking entity does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the foreign public fund (after the seeding period),[10] and provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with applicable limitations in the relevant foreign jurisdiction. Nor would the staffs advise that a foreign public fund be deemed a banking entity under the final rule solely by virtue of its relationship with the sponsoring banking entity where the foreign public fund meets the requirements of section 351.10(c)(1) of the final rule and the sponsoring banking entity's relationship with the foreign public fund meets the requirements of section 351.12(b)(1) of the final rule, including the requirement that the sponsoring banking entity's relationship with the fund is in compliance with applicable limitations in the foreign jurisdiction in which the foreign public fund operates.

[10] See §§ 351.10(c)(12) and 351.20(e). The preamble to the final rule makes clear that, consistent with the Board's precedent regarding bank holding company control of and relationships with funds, a seeding vehicle that will become a registered investment company would not itself be viewed as violating the requirements of section 13 during the seeding period so long as the banking entity that establishes the seeding vehicle operates the vehicle pursuant to a written plan, developed in accordance with the banking entity's compliance program, that reflects the banking entity's determination that the vehicle will become a registered investment company within the time period provided for seeding a covered fund. See 79 FR at 5676-77. The staffs of the Agencies have explained that an issuer that will become a foreign public fund would be treated during its seeding period in the same manner as an issuer that will become an excluded registered investment company. https://fdic.gov/regulations/reform/volcker/faq/foreign.html.

May an issuer that would be a covered fund rely on the joint venture exclusion from the definition of covered fund under § 351.10(c)(3) of the final rule?

Section 351.10(c)(3) of the final rule provides that a covered fund does not include a joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, provided that the joint venture:

- Is comprised of no more than 10 unaffiliated co-venturers;
- Is in the business of engaging in activities that are permissible for the banking entity or affiliate, other than investing in securities for resale or other disposition; and
- Is not, and does not hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities.

As explained in the preamble to the final rule, one of the purposes of section 13 of the Bank Holding Company Act ("BHC Act") is to limit investment and sponsorship activities of banking entities in hedge funds and private equity funds, which section 13 of the BHC Act generally defines as entities that rely on certain specified exclusions in the Investment Company Act of 1940.[1] The final rule defines hedge funds and private equity funds collectively as "covered funds."[2] The preamble to the final rule explains that the definition of covered fund focuses on the types of entities formed for the purpose of investing in securities or derivatives for resale or other trading activity that are not subject to all of the securities law protections applicable to funds that are registered with the SEC as investment companies. A joint venture that qualifies for the joint venture exclusion in the final rule, however, is excluded from the definition of covered fund.

The conditions to the joint venture exclusion reflect that the exclusion is designed to be used by a banking entity to conduct businesses and operations in conjunction with a limited number of co-venturers and that the exclusion is not intended to include entities that invest in securities for resale or other disposition. Similarly, the exclusion would not apply to entities or arrangements that raise money from investors primarily for the purpose of investing in securities for the benefit of one or more investors and sharing the income, gain or losses on securities acquired by that entity. The limitations in the joint venture exclusion are meant to ensure that the joint venture is

---

[1] See, e.g., *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 79 FR 5536 (Jan. 31, 2014) at 5670-5671.

[2] The final rule generally defines the term "covered fund" to include certain funds that rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940; certain commodity pools as defined in section 1a(10) of the Commodity Exchange Act; and certain foreign funds. See section 351.10(b)(1) of the final rule.

not an investment vehicle and that the joint venture exclusion is not used as a means to evade the limitations in the BHC Act on investing in covered funds. [3]

This exclusion is not met by an issuer that raises money from a small number of investors primarily for the purpose of investing in securities, whether the securities are intended to be traded frequently, held for a longer duration, held to maturity, or held until the dissolution of the entity. The exclusion also is not met by an entity that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities merely because one of the purposes for establishing the vehicle may be to provide financing to an entity to obtain and hold securities. As the preamble explains, the exclusion is designed to allow a banking entity to more efficiently manage the risks of its banking operations by, for example, seeking to obtain or share complementary business expertise. The conditions imposed on the exclusion are specifically intended to prevent the exclusion from being used as a vehicle to raise funds from investors primarily for the purpose of profiting from investment activity in securities for resale or other disposition or otherwise trading in securities.[4] Thus, for example, a vehicle that raises funds from investors primarily for the purpose of sharing in the benefits, income, gains or losses from ownership of securities – as opposed to conducting a business or engaging in operations or other non-investment activities – would be raising money from investors primarily for the purpose of "investing in securities," even if the vehicle may have other purposes.[5]

---

[3] The joint venture exclusion is subject to conditions, as noted above. As an initial matter, the entity seeking to rely on the exclusion must be a joint venture. While the term "joint venture" is not defined separately in the final rule, the Agencies' staffs note that the basic elements of a joint venture are well recognized, including under state law. Although any determination of whether an arrangement is a joint venture will depend on the facts and circumstances, the Agencies' staffs generally would not expect that a person that does not have some degree of control over the business of an entity would be considered to be participating in "a joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons" as specified in § 351.10(c)(3) of the final rule.

[4] See 79 FR 5536 at 5680-82.

[5] See, e.g., 79 FR 5536 at 5681 (stating that the limit on the number of co-venturers "allows flexibility in structuring larger business ventures without involving such a large number of partners as to suggest the venture is in reality a hedge fund or private equity fund established for investment purposes" and that "[t]he Agencies will monitor joint ventures—and other excluded entities—to ensure that they are not used by banking entities to evade the provisions of section 13"; also stating that "[t]he final rule's requirement that a joint venture not be an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities prevents a banking entity from relying on this exclusion to evade section 13 of the BHC Act by owning or sponsoring what is or will become a covered fund").

<u>Loan Securitization Servicing Assets</u>

Question: Are the "rights or other assets" described in § 351.10(c)(8)(i)(B) ("servicing assets") limited to "permitted securities," or can other assets be servicing assets for purposes of the loan securitization exclusion?

Answer: The exclusion from the definition of covered fund for loan securitizations provides that, in addition to loans, a loan securitization may hold rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset meets the requirements of § 351.10(c)(8)(iii) of the final rule.

Under the final rule, servicing assets may be any type of asset. However, any servicing asset that is a security must be a permitted security under § 351.10(c)(8)(iii). Permitted securities under this section include cash equivalents and securities received in lieu of debts previously contracted as set forth in § 351.10(c)(8)(iii). The preamble to the final rule provides additional detail on the meaning of cash equivalents, noting that the Agencies interpret "cash equivalents" to mean high quality, highly liquid short term investments whose maturity corresponds to the securitization's expected or potential need for funds and whose currency corresponds to either the underlying loans or the asset-backed securities.

<u>Metrics Reporting Date</u>

Question: To comply with the requirement to record and report quantitative measurements in § 351.20(d) and Appendix A, when must a banking entity with $50 billion or greater in trading assets and liabilities begin to measure and record the required metrics? When must the banking entity begin to report metrics data to the FDIC?

Answer: A banking entity with trading assets and liabilities of at least $50 billion, as calculated under § 351.20(d)(1), must begin to measure and record the required metrics on a daily basis starting July 1, 2014. As explained below, this banking entity must report its daily metrics recorded during the month of July to the FDIC by September 2, 2014.

Section 351.20(d)(2) provides that the threshold for reporting quantitative measurements under § 351.20(d)(1) is $50 billion beginning on June 30, 2014. This means that the first day for which daily metrics must be measured and recorded by a banking entity at the $50 billion threshold is July 1, 2014.

The final rule requires a banking entity at or above the $50 billion threshold to report metrics data for each calendar month within 30 days of the end of the month unless the Board notifies the banking entity in writing that it must report on a different basis. However, if the reporting deadline occurs on a Saturday, Sunday, or federal holiday, then a banking entity may report the data on the next business day following the reporting deadline. Thus, the relevant banking entity must collect metrics data for the month of July and report that data by September 2, 2014. This banking entity has until September 2, 2014 to report metrics data under these circumstances because August 30, 2014 (which is 30 days after July 31, 2014) is a Saturday, and the following Monday on September 1, 2014 is a federal holiday. Beginning with information for the month of January 2015, the final rule requires this banking entity to report metrics data within 10 days of the end of each calendar month, unless the Board notifies the banking entity in writing that it must report on a different basis.

Certain of the required metrics have a calculation period of 30 days, 60 days, and 90 days. For these measurements, the initial metrics report for the month of July may provide data for only a 30-day calculation period. Likewise, the metrics report due by September 30, 2014 may provide data for only a 30-day and 60-day calculation period. Beginning with the report due October 30, 2014, metrics reports must include data for all required calculation periods.

Metrics Reporting During the Conformance Period

Appendix A of the final rule provides that certain of the metrics required to be reported by banking entities under the final rule should include the limits set out in §§ 351.4 and 351.5 of the final rule. Since the limits required by §§ 351.4 and 351.5 of the final rule are not required to be established prior to the end of the conformance period, when would a banking entity need to report metrics that include these limits?

A banking entity must conform its activities and investments to the prohibitions and restrictions of the final rule implementing section 13 of the Bank Holding Company Act no later than the end of the conformance period.[1] During this conformance period, some banking entities are nonetheless required to report certain quantitative measurements to the appropriate Agency under Appendix A of the final rule.[2] Appendix A provides that Risk and Position Limits and Usage should include the limits set out in §§ 351.4 and 351.5 of the final rule and explains that a number of metrics such as Risk Factor Sensitivities, Value-at-Risk, and Stress Value-at-Risk relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market-making-related activities under § 351.4(b) and the risk-mitigating hedging activities under § 351.5.[3]

The limits required under the underwriting, market-making, and risk-mitigating hedging sections of the final rule must be in place by the end of the conformance period. A banking entity that reports metrics under Appendix A prior to the end of the conformance period need not report the limits required by §§ 351.4(a)(2)(iii), 351.4(b)(2)(iii), and 351.5(b)(1)(i) until the end of the conformance period. However, if such a banking entity already has in place or develops limits of the type described in §§ 351.4 and 351.5 prior to the end of the conformance period, the banking entity is urged to report such limits as part of its reporting of quantitative measurements to the appropriate Agency.

---

[1] See Federal Reserve System, Order Approving Extension of Conformance Period (Dec. 10, 2013), available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf.

[2] See 12 CFR 351.20(d).

[3] See Appendix A, 79 FR 5536 at 5798.

Namesharing Prohibition

Question: Section 351.11 of the final rule provides that a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity organizes and offers, subject to a number of conditions. Among other things, these conditions require that the covered fund, for corporate, marketing, promotional or other purposes does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof). What does it mean for a covered fund to share the same name or a variation of the same name with a banking entity?

Answer: A covered fund that is organized and offered by "banking entity A" may not share the same name or a variation of the same name as "banking entity A," nor may it share the same name or a variation of the same name as any affiliate of "banking entity A." Additionally, the final rule prohibits a covered fund from using the word "bank" in its name.

Similar restrictions on a fund sharing the same name, or variation of the same name, with an insured depository institution or company that controls an insured depository institution or having the word "bank" in its name, have been used previously in order to prevent customer confusion regarding the relationship between such companies and a fund.[4] In order to comply with § 351.11(a)(6) of the final rule and not be considered to share the same name or variation of the same name with a banking entity, the name of a covered fund must be sufficiently distinct from the name of the banking entity that the covered fund's use of the name would not likely lead to customer confusion regarding the relationship between the banking entity and the covered fund. For instance, a covered fund would generally be considered to share the same name or a variation of the same name with a banking entity if the name of the fund features the same root word, initials or a logo, trademark, or other corporate symbol that is also used by, or that clearly references a connection with, the banking entity, including any affiliate of the banking entity. Additionally, materials used to market, promote, or offer the fund may not contain any statements that would mislead an investor into thinking that the banking entity or any of its affiliates, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or any covered fund in which such covered fund invests.

[4] See, e.g., 12 CFR 225.125(f); Bank of Ireland, 82 Fed. Res. Bull. 1129, 1132 (1996).

CEO Certification for Prime Brokerage Transactions

When is a banking entity required to submit the annual CEO certification for prime brokerage transactions required by §351.14(a)(2)(ii)(B) of the final rule? What about legacy covered funds?

Section 351.14(a)(1) of the final rule prohibits a banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, that organizes and offers a covered fund pursuant to §351.11 of the final rule or that holds an ownership interest in accordance with §351.11(b), and any affiliate of the banking entity, from entering into a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)) with the covered fund or with any other covered fund that is controlled by such covered fund. Notwithstanding this prohibition, §351.14(a)(2) provides that a banking entity may enter into any prime brokerage transaction[1] with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate) has taken an ownership interest, so long as the conditions enumerated in the final rule are satisfied.[2] One of the conditions requires a written CEO certification annually.[3]

Staffs of the Agencies believe that banking entities that are required to provide the annual CEO certification for prime brokerage transactions as of the end of the conformance period should submit the first CEO certification required under §351.14 after the end of the conformance period but no later than March 31, 2016.[4] A banking entity may provide the required annual certification in writing at any time prior to the March 31 deadline to the relevant Agency.

The conformance period for investments in and relationships with a legacy covered fund (i.e., a covered fund sponsored or owned by a banking entity prior to December 31, 2013) currently ends on July 21, 2016.[5] Banking entities that engage in prime brokerage transactions

---

1 The final rule defines "prime brokerage transaction" to mean any transaction that would be a covered transaction, as defined in section 23A(b)(7) of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), that is provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, or data, operational, and administrative support. See 12 CFR 351.10(d)(7).

2 See 12 CFR 351.14(a)(2) & (c); see also 79 FR at 5747.

3 See 12 CFR 351.14(a)(2)(ii)(B).

4 See FAQ #7 http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#7 ("The staffs of the Agencies believe that banking entities subject to Appendix B as of the end of the conformance period should submit the first CEO attestation required under Appendix B after the end of the conformance period but no later than March 31, 2016.").

5 The Board granted banking entities until July 21, 2016 to conform investments in and relationships with covered funds that were in place prior to December 31, 2013 and announced its intention to act next year to grant banking entities until July 21, 2017 to conform investments in and relationships with legacy covered funds. See Board Order Approving Extension of Conformance Period under Section 13 of the

with legacy covered funds should submit their first CEO certification by March 31 following the end of the relevant conformance period.

In any case, a banking entity should provide the CEO certification annually within one year of its prior attestation. Moreover, under the final rule, the CEO has a duty to update the certification if the information in the certification materially changes at any time during the year when he or she becomes aware of the material change.

Bank Holding Company Act (December 18, 2014), available at http://www.federalreserve.gov/newsevents/press/bcreg/20141218a.htm. A banking entity would thus have until July 21, 2017 to conform its relationships with legacy covered funds.

Is a registered investment company or a foreign public fund a banking entity subject to section 13 of the BHC Act and implementing rules during its seeding period?

The rule implementing section 13 of the Bank Holding Company Act ("BHC Act") and the accompanying preamble make clear that a registered investment company ("RIC") and a foreign public fund ("FPF") are not covered funds for purposes of the statute or implementing rules.[1] The preamble to the implementing rules also recognize that a banking entity may own a significant portion of the shares of a RIC or FPF during a brief period during which the banking entity is testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes, and attempting to distribute the fund's shares (the so-called seeding period).[2]

Staff of the Agencies would not advise the Agencies to treat a RIC or FPF as a banking entity under the implementing rules solely on the basis that the RIC or FPF is established with a limited seeding period, absent other evidence that the RIC or FPF was being used to evade section 13 and the implementing rules. The staffs of the Agencies understand that the seeding period for an entity that is a RIC or FPF may take some time, for example, three years, the maximum period of time expressly permitted for seeding a covered fund under the implementing rules.[3] The seeding period generally would be measured from the date on which the investment adviser or similar entity begins making investments pursuant to the written investment strategy of the fund.[4] Accordingly, staff of the Agencies would not advise the Agencies to treat a RIC or FPF as a banking entity solely on the basis of the level of ownership of the RIC or FPF by a banking entity during a seeding period or expect an application to be submitted to the Board to determine the length of the seeding period.[5]

---

[1] See §351.10(c)(1) (excluding a FPF from the definition of covered fund); §351.10(c)(12) (excluding from the definition of covered fund an issuer that is a RIC under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8)).

[2] See 79 FR at 5676-77; see also §351.10(c)(12) (excluding from the definition of covered fund an issuer formed and operated pursuant to a written plan to become a RIC); FAQ #5, available at: http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#5 (stating that "it would be appropriate that an issuer that will become an excluded foreign public fund be treated during its seeding period the same as an issuer that will become an excluded RIC").

[3] See § 351.10(c)(12); § 351.12(a)(2)(i)(B)); § 351.12(e); § 351.20(e).

[4] See § 351.12(a)(2) (describing seeding periods for a covered fund that is not issuing asset-backed securities).

[5] The final rule requires a vehicle that is a covered fund (as opposed to a RIC or a FPF) during its seeding period and that is formed and operated pursuant to a written plan to become a RIC to apply to the Board for an extension of the one-year seeding period already granted to such covered funds. See § 351.10(c)(12); § 351.12(a)(2)(i)(B)); § 351.12(e); § 351.20(e). The implementing rule also excludes from the definition of covered fund an issuer that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act and has not withdrawn that election ("SEC-regulated BDC"), or that is formed and operated pursuant to a written plan to become a business development company as described in § 351.20(e)(3) of subpart D and that complies with the requirements of section 61 of the Investment Company Act of 1940 company. See § 351.10(c)(12)(iii). The staffs, consistent with the final rule's parallel treatment of RICs, FPFs, and SEC-regulated BDCs,

also would not advise the Agencies to treat an SEC-regulated BDC as a banking entity solely on the basis of the level of ownership of the SEC-regulated BDC by a banking entity during a seeding period.

SOTUS Covered Fund Exemption: Marketing Restriction

Question: Section 13(d)(1)(I) of the Bank Holding Company Act ("BHC Act") and section 351.13(b) of the final rule provide an exemption for certain covered fund activities conducted by foreign banking entities (the "SOTUS covered fund exemption") provided that, among other conditions, "no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States" (the "marketing restriction"). Does the marketing restriction apply only to the activities of a foreign banking entity that is seeking to rely on the SOTUS covered fund exemption or does it apply more generally to the activities of any person offering for sale or selling ownership interests in the covered fund? Sponsors of covered funds and foreign banking entities have asked how this condition would apply to a foreign banking entity that has made, or intends to make, an investment in a covered fund where the foreign banking entity (including its affiliates) does not sponsor, or serve, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to, the covered fund (a "third-party covered fund").

Answer: The staffs of the Agencies believe that the marketing restriction applies to the activities of the foreign banking entity that is seeking to rely on the SOTUS covered fund exemption (including its affiliates). This is also reflected in the preamble discussion of the marketing restriction and the structure of the final rule as discussed below.

Consistent with Section 13(d)(1)(I) of the BHC Act, the marketing restriction in the final rule provides that "no ownership interest in the covered fund is offered for sale or sold to a resident of the United States." Section 351.13(b)(3) of the final rule provides that an ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of the marketing restriction if it is sold or has been sold pursuant to an offering that does not target residents of the United States. In describing the marketing restriction in the preamble, the Agencies stated that the marketing restriction serves to limit the SOTUS covered fund exemption so that it "does not advantage foreign banking entities relative to U.S. banking entities with respect to providing <u>their</u> covered fund services in the United States by prohibiting the offer or sale of ownership interests in <u>related</u> covered funds to residents of the United States."[1]

The marketing restriction, as implemented in the final rule, constrains the foreign banking entity in connection with its own activities with respect to covered funds rather than the activities of unaffiliated third parties, thereby ensuring that the foreign banking entity seeking to rely on the SOTUS covered fund exemption does not engage in an offering of ownership interests that targets residents of the United States.

[1] <u>See</u> Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 FR 5536 at 5742 (Jan. 31, 2014) (emphasis added).

This view is consistent with limiting the extraterritorial application of section 13 to foreign banking entities while seeking to ensure that the risks of covered fund investments by foreign banking entities occur and remain solely outside of the United States.[2] If the marketing restriction were applied to the activities of third parties, such as the sponsor of a third-party covered fund (rather than the foreign banking entity investing in a third-party covered fund), the SOTUS covered fund exemption may not be available in certain circumstances where the risks and activities of a foreign banking entity with respect to its investment in the covered fund are solely outside the United States.[3]

A foreign banking entity (including its affiliates) that seeks to rely on the SOTUS covered fund exemption must comply with all of the conditions to that exemption, including the marketing restriction. A foreign banking entity that participates in an offer or sale of covered fund interests to a resident of the United States thus cannot rely on the SOTUS covered fund exemption with respect to that covered fund. Further, where a banking entity sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, that banking entity will be viewed by the staffs as participating in any offer or sale by the covered fund of ownership interests in the covered fund, and therefore such foreign banking entity would not qualify for the SOTUS covered fund exemption for that covered fund if that covered fund offers or sells covered fund ownership interests to a resident of the United States.

---

[2] See id. at 5740.

[3] The staffs also note that foreign funds that sell securities to residents of the United States in an offering that targets residents of the United States will be covered funds under section 351.10(b)(i) of the final rule if such funds are unable to rely on an exclusion or exemption under the Investment Company Act other than section 3(c)(1) or 3(c)(7) of that Act. If the marketing restriction were to apply more generally to the activities of any person (including the covered fund itself), the applicability of the SOTUS covered fund exemption would be significantly limited because a third-party foreign fund's offering that targets residents of the United States would make the SOTUS covered fund exemption unavailable for all foreign banking entity investors in the fund. The Agencies' discussion of the SOTUS covered fund exemption in the preamble does not suggest that the Agencies understood the SOTUS covered fund exemption to have such a limited application.

The Volcker Rule: Frequently Asked Questions

Treasury STRIPS

Are interest-only and principal-only STRIPS of notes and bonds issued by the U.S. Treasury considered "obligations of, or issued or guaranteed by, the United States" under 12 CFR 248.6(a)(1) of the final rule implementing section 13 of the BHC Act? Is the same true for securities reconstituted from STRIPS of U.S. Treasury notes or bonds?

Yes. Under the Department of the Treasury's Separate Trading of Registered Interest and Principal of Securities program, eligible Treasury securities are authorized to be separated into principal and interest components and transferred separately.[1] These separate principal and interest components are also referred to as "STRIPS." Like the fully constituted security, payments of principal and interest under these STRIPS are backed by the full faith and credit of the United States.[2] Thus, the interest-only and principal-only components are obligations of, or issued or guaranteed by, the United States that would qualify for the exemption provided under § 248.6(a)(1) of the final rule implementing section 13 of the BHC Act.

In addition, Treasury regulations allow financial institutions and government securities brokers or dealers to reassemble corresponding STRIPS into their fully constituted form.[3] This reconstituted security is also an obligation of, or issued or guaranteed by, the United States under § 248.6(a)(1) of the final rule.

[1] 31 CFR 356.4.

[2] *See* 51 Fed. Reg. 29085, 29088–89 (Aug. 14, 1986) (OCC interpretive ruling citing Memorandum from Walter T. Eccard, Assistant General Counsel for Banking and Finance, Department of the Treasury, to Jordan Luke, Deputy Chief Counsel (Policy), OCC (May 29, 1986)); *accord* Call Report Glossary, at A-14b (Dec 2014) ("Even after the interest or principal portions of U.S. Treasury STRIPS have been separately traded, they remain obligations of the U.S. Government.").

[3] 31 CFR 356.31(d); *see also* http://www.treasurydirect.gov/instit/marketables/strips/strips.htm.

<u>Trading Desk</u>

Question: May a trading desk span multiple affiliated banking entities? If a trading desk spans multiple affiliated banking entities, to which Agency(ies) should a banking entity report metrics?

The final rule defines trading desk to mean 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. As discussed in the preamble to the final rule, the Agencies expect that a trading desk would be managed and operated as an individual unit and should reflect the level at which the profit and loss of the traders is attributed. This approach allows more effective management of risks of trading activity by requiring the establishment of limits, management oversight, and accountability at the level where the trading activity occurs. It also allows banking entities to tailor the limits and procedures to the type of instruments traded and markets served by each trading desk.

The definition of "trading desk" specifically recognizes that the desk may buy or sell financial instruments "for the trading account of a banking entity or an affiliate thereof." The preamble to the final rule explains that a trading desk may span more than one legal entity and thus employees may be working on behalf of multiple affiliated legal entities. Additionally, trades and positions managed by the desk may be booked in different affiliated entities. The rules require that if a single trading desk books positions in different affiliated legal entities, it must have records that identify all positions included in the trading desk's financial exposure and the legal entities where such positions are held.

Appendix A to the final rule provides that a banking entity with significant trading assets and liabilities must furnish periodic reports to the Agencies regarding a variety of quantitative measurements of their covered trading activities. If a trading desk spans multiple legal entities, it must report quantitative measurements to each of the agencies with jurisdiction under section 13 of the BHC Act over any of the entities. For a trading desk that spans multiple affiliated banking entities, the quantitative measurements of Appendix A should be calculated at the level of the entire desk; calculations do not need to be performed separately for each subset of positions booked at the various banking entities that compose the trading desk. As indicated above, this same set of desk-wide measurements should be reported to each Agency that has authority under section 13 of the BHC Act over any of the affiliated entities that compose the trading desk so that the Agency may understand the context of the trading activity and discharge its responsibility for the legal entity that the Agency supervises or regulates.

Mortgage-Backed Securities of Government-Sponsored Enterprises

How are certain mortgage-backed securities issuers sponsored by government-sponsored enterprises ("GSEs") treated under the final rule's covered funds provisions?

Section 351(10(c)(12)(ii) of the final rule excludes from the definition of a covered fund an issuer that may rely on an exclusion or exemption from the definition of "investment company" under the Investment Company Act of 1940 other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act. The SEC has stated that, "certain federally sponsored structured financings, such as those sponsored by the Federal National Mortgage Association, are exempted from the [Investment Company] Act under section 2(b), which exempts, among other things, activities of United States Government instrumentalities and wholly owned corporations of such instrumentalities."[1] To the extent that an issuer may rely on section 2(b) of the Investment Company Act, the issuer would be relying on an exemption from regulation under the Investment Company Act other than the exclusions contained in section 3(c)(1) or 3(c)(7), and thus would qualify for the exclusion from the covered fund definition provided by section 351.10(c)(12)(ii) of the final rule.

[1] *See Exclusion From the Definition of Investment Company for Certain Structured Financings*, Investment Company Act Rel. No. 18736 (June 5, 1992). In addition, staff in the SEC's Division of Investment Management have taken the position, based on the facts and representations presented to the staff in each case, that certain GSE-sponsored mortgage-backed securities issuers would not be required to register under the Investment Company Act in reliance on section 2(b) of that Act. *See, e.g.*, Federal National Mortgage Association, SEC No-Action Letter (May 25, 1988) (expressing the staff's view that the Federal National Mortgage Association ("Fannie Mae") "is excluded from the 1940 Act under Section 2(b) as an instrumentality of the United States" and that Fannie Mae, rather than certain trusts, is the issuer for purposes of sections 3(a)(1) and 3(a)(3) of the Investment Company Act).

Capital Treatment of Banking Entity Investments in TruPS CDOs

Is a banking entity required to deduct from its tier 1 capital an investment in a collateralized debt obligation backed by trust preferred securities retained pursuant to section 351.16(a) of the interim final rule ("Qualifying TruPS CDO")?

No, a banking entity is not required to deduct from its tier 1 capital an investment in a Qualifying TruPS CDO retained pursuant to section 351.16(a) of the interim final rule. Section 13 of the BHC Act generally prohibits a banking entity from acquiring or retaining any ownership interest in, or acting as a sponsor to, a hedge fund or private equity fund ("covered fund"),[1] subject to a number of exemptions. The Agencies issued final rules to implement section 13 of the BHC Act in December 2013. Shortly thereafter, in January 2014, the Agencies adopted an interim final rule to add section 351.16 to the final rules implementing section 13 of the BHC Act.[2] Section 351.16(a) of the interim final rule permitted banking entities to retain an interest in, or act as sponsor (including as trustee), of an issuer of collateralized debt obligations backed by trust preferred securities ("TruPS CDOs"), so long as: (i) the issuer was established, and the interest was issued, 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;[3] and (iii) the banking entity's interest in the vehicle was acquired on or before

---

[1] See 12 U.S.C. 1851(a)(1)(B); see also 12 CFR 351.10(a).

[2] See Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities With Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 FR 5223 (Jan. 31, 2014).

[3] Under the interim final rule, a "Qualifying TruPS Collateral" is defined by reference to the standards in section 171(b)(4)(C) of the Dodd-Frank Act 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 within 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. See 12 CFR 351.16(b).

December 10, 2013 (or acquired in connection with a merger or acquisition of a banking entity that acquired the interest on or before December 10, 2013).[4]

Section 13(d)(4) of the BHC Act allows a banking entity to make and retain investments in a covered fund that the banking entity organizes and offers subject to certain limitations and restrictions, which are enumerated in subparagraph (B), for the purposes of: (1) establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors; or (2) making a de minimis investment.[5] Section 13(d)(4)(B)(iii) requires that the aggregate amount of outstanding investments made by a banking entity in reliance on section 13(d)(4), including retained earnings, be deducted from the assets and tangible equity of the banking entity.[6] Section 351.12 of the final rule implements the exemption contained in section 13(d)(4) of the BHC Act from the prohibition on investment in covered funds for de minimis investments that meet the statutory requirements and limitations, including the requirement that the banking entity deduct from the banking entity's tier 1 capital the full amount of its investment in the covered fund for purposes of calculating compliance with applicable regulatory capital requirements.[7]

These requirements in section 351.12 of the final rule do not apply to Qualifying TruPS CDOs held in accordance with section 351.16(a) of the final rules because section 351.16(a) provides an additional and independent exemption for Qualifying TruPS CDOs.[8] If, however, a banking entity acts as a market maker with respect to interests in a

---

[4] See 12 CFR 351.16(a).

[5] 12 U.S.C. 1851(d)(4)(A)(i)-(ii).

[6] 12 U.S.C. 1851(d)(4)(B)(iii).

[7] 12 CFR 351.12.

[8] The preamble to the final rule explained: "As in the statute, the proposed rule applied the capital deduction to ownership interests in covered funds held as an investment by a banking entity pursuant to the provisions of section 13(d)(4) of the BHC Act, and not to ownership interests acquired under other permitted authorities, such as a risk-mitigating hedge under section 13 of the BHC Act." See 79 FR at 5730. As noted above, section 13(d)(4) permits a banking

Qualifying TruPS CDO that is a covered fund, then section 351.11(c) of the final rule makes the capital deduction provision in section 351.12 applicable to those interests.[9] Moreover, if a banking entity relies on section 351.12 to hold an interest in a TruPS CDO that is a covered fund but is not a Qualifying TruPS CDO, the banking entity would be required to comply with all the limits and restrictions in section 351.12, including the requirement to deduct its investment from its tier 1 capital for purposes of determining compliance with applicable regulatory capital requirements.

---

entity to make and retain an investment in a covered fund to establish the fund or to make a de minimis investment in connection with organizing and offering the fund.

[9] See 12 CFR 351.11(c). See also 12 CFR 351.16(c) ("Notwithstanding paragraph (a)(3) of this section, a banking entity may act as a market maker with respect to the interests of an issuer described in paragraph (a) of this section in accordance with the applicable provisions of §§ __.4 and __.11.").