DEPARTMENT OF TREASURY

Office of the Comptroller of the Currency

12 CFR Part 44

[Docket No. OCC–2018–0010]

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FEDERAL RESERVE SYSTEM

12 CFR Part 248

[Docket No. R–1608]

RIN 7100–AF 06

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 351

RIN 3064–AE67

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 75

RIN 3038–AE72

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 255

[Release no. BHCA–7; File no. S7–14–18]

RIN 3235–AM10

Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

AGENCY: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Securities and Exchange Commission (SEC); and Commodity Futures Trading Commission (CFTC).

ACTION: Final rule.

SUMMARY: The OCC, Board, FDIC, SEC, and CFTC are adopting amendments to the regulations implementing section 13 of the Bank Holding Company Act. Section 13 contains certain restrictions on the ability of a banking entity and nonbank financial company supervised by the Board to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund. These final amendments are intended to provide banking entities with clarity about what activities are prohibited and to improve supervision and implementation of section 13.

DATES:

Effective date: The effective date for amendatory instructions 1 through 14 (OCC), 16 through 29 (Board), 31 through 44 (FDIC), and 46 through 58 (CFTC) is January 1, 2020; the effective date for amendatory instructions 60 through 73 (SEC) is January 13, 2020; and the effective date for the addition of appendices Z at amendatory instructions 15 (OCC), 30 (Board), and 45 (FDIC) is January 1, 2020, through December 31, 2020, except for amendatory instruction 74 (SEC), which is effective January 13, 2020, through December 31, 2020.

Compliance date: Banking entities must comply with the final amendments by January 1, 2021. Until the compliance date, banking entities must continue to comply with the 2013 rule (as set forth in appendices Z to 12 CFR parts 44, 248, and 351 and 17 CFR parts 75 and 255). Alternatively, a banking entity may voluntarily comply, in whole or in part, with the amendments adopted in this release prior to the compliance date, subject to the agencies' completion of necessary technological changes.

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SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background

Section 13 of the Bank Holding Company Act of 1956 (BHC Act),[1] also known as the Volcker Rule, generally prohibits any banking entity from engaging in proprietary trading or from

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

acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (covered fund).[2] The statute expressly exempts from these prohibitions various activities, including among other things:

- Trading in U.S. government, agency, and municipal obligations;
- Underwriting and market making-related activities;
- Risk-mitigating hedging activities;
- Trading on behalf of customers;
- Trading for the general account of insurance companies; and
- Foreign trading by non-U.S. banking entities.[3]

In addition, section 13 of the BHC Act contains several exemptions that permit banking entities to engage in certain activities with respect to covered funds, subject to certain restrictions designed to ensure that banking entities do not rescue investors in those funds from loss, and do not guarantee nor expose themselves to significant losses due to investments in or other relationships with these funds.[4]

Authority under section 13 for developing and adopting regulations to implement the prohibitions and restrictions of section 13 of the BHC Act is shared among the Board, the FDIC, the OCC, the SEC, and the CFTC (individually, an agency, and collectively, the agencies).[5] The agencies issued a final rule implementing section 13 of the BHC Act in December 2013 (the 2013 rule), and those provisions became effective on April 1, 2014.[6]

Since the adoption of the 2013 rule, the agencies have gained several years of experience implementing the 2013 rule, and banking entities have had more than five years of becoming familiar and complying with the 2013 rule. The agencies have received various communications from the public and other sources since adoption of the 2013 rule and over the course of the 2013 rule's implementation. Staffs of the agencies also have held numerous meetings with banking entities and other market participants to discuss the 2013 rule and its implementation. In addition, the data collected in connection with the 2013 rule, compliance efforts by banking entities, and the agencies' experiences in reviewing trading, investment, and other activity under the 2013 rule have provided valuable insights into the effectiveness of the 2013 rule. Together, these experiences have highlighted areas in which the 2013 rule may have resulted in ambiguity, overbroad application, or unduly complex compliance routines or may otherwise not have been as effective or efficient in achieving its purpose as intended or expected.

II. Notice of Proposed Rulemaking

Based on their experience implementing the 2013 rule, the agencies published a notice of proposed rulemaking (the proposed rule or proposal) on July 17, 2018, that proposed amendments to the 2013 rule. These amendments sought to provide greater clarity and certainty about what activities are prohibited under the 2013 rule and to improve the effective allocation of compliance resources where possible.[7]

The agencies sought to address a number of targeted areas for revision in the proposal. First, the agencies proposed further tailoring to make the scale of compliance activity required by the 2013 rule commensurate with a banking entity's size and level of trading activity. In particular, the agencies proposed to establish three categories of banking entities based on the firms' level of trading activity—those with significant trading assets and liabilities, those with moderate trading assets and liabilities, and those with limited trading assets and liabilities.[8] The agencies also invited comments on whether certain definitions, including ''banking entity'' [9] and ''trading desk,'' [10] and ''covered fund'' [11] should be modified.

The agencies also proposed making several changes to subpart B of the 2013 rule, which implements the statutory prohibition on proprietary trading and the various statutory exemptions to this prohibition. The agencies proposed revisions to the trading account definition,[12] including replacing the short-term intent prong of the trading account definition in the 2013 rule with a new prong based on the accounting treatment of a position (the accounting prong) and, with respect to trading activity subject only to the accounting prong, establishing a presumption of compliance with the prohibition on proprietary trading, based on the absolute value of a trading desk's profit and loss.[13] Under the proposed accounting prong, the trading account would have encompassed financial instruments recorded at fair value on a recurring basis under applicable accounting standards.

In addition, the proposal would have modified several of the exemptions and exclusions from the prohibition on proprietary trading in subpart B to clarify how banking entities may qualify for those exemptions and exclusions, as well as to reduce associated compliance burdens. For example, the agencies proposed revising the 2013 rule's exemptions for underwriting and market making-related activities,[14] the exemption for risk-mitigating hedging activities,[15] the exemption for trading by a foreign banking entity that occurs solely outside of the United States,[16] and the liquidity management exclusion.[17] In addition, the agencies proposed establishing an exclusion for transactions to correct trading errors.[18]

The agencies also proposed certain modifications to the prohibitions in subpart C on banking entities directly or indirectly acquiring or retaining an ownership interest in, or having certain relationships with, a covered fund. For example, the proposed rule would have modified provisions related to the underwriting or market making of ownership interests in covered funds [19] and the exemption for certain permitted covered fund activities and investments outside of the United States. The proposal also would have expanded a banking entity's ability to engage in hedging activities involving an ownership interest in a covered fund.[20] In addition, the agencies requested comment regarding tailoring the definition of ''covered fund,'' including potential additional exclusions,[21] and revising the provisions limiting banking entities' relationships with covered funds.[22]

To enhance compliance efficiencies, the agencies proposed tailoring the

[2] *Id.*

[3] 12 U.S.C. 1851(d)(1).

[4] *E.g.,* 12 U.S.C. 1851(d)(1)(G).

[5] 12 U.S.C. 1851(b)(2).

[6] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule, 79 FR 5535 (Jan. 31, 2014).

[7] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 FR 33432 (July 17, 2018).

[8] *See* 83 FR 33437, 40–42.

[9] *See* 83 FR 33442–46.

[10] *See* 83 FR 33453–54.

[11] *See* 83 FR 33471–82.

[12] The definition of ''trading account'' is a threshold definition that determines whether the purchase or sale of a financial instrument by a banking entity is subject to the restrictions and requirements of section 13 of the BHC Act and the 2013 rule.

[13] *See* 83 FR 33446–51.

[14] *See* 83 FR 33454–62.

[15] *See* 83 FR 33464–67.

[16] *See* 83 FR 33467–70.

[17] *See* 83 FR 33451–52.

[18] *See* 83 FR 33452–53.

[19] *See* 83 FR 33482–83

[20] *See* 83 FR 33483–86.

[21] *See* 83 FR 33471–82.

[22] *See* 83 FR 33486–87.

compliance requirements based on new compliance tiers. The proposed rule would have applied the six-pillar compliance program, and a CEO attestation requirement largely consistent with the 2013 rule, to firms with significant trading assets and liabilities and eliminated the enhanced minimum standards for compliance programs in Appendix B of the 2013 rule.[23] Firms with moderate trading assets and liabilities would have been required to adhere to a simplified compliance program, with a CEO attestation requirement,[24] and firms with limited trading assets and liabilities would have had a presumption of compliance with the rule.[25] The proposal also included a reservation of authority specifying that the agencies could impose additional requirements on banking entities with limited or moderate trading assets and liabilities if warranted.[26] The proposal would have revised the metrics reporting and recordkeeping requirements by, for example, applying those requirements based on a banking entity's size and level of trading activity, eliminating some metrics, and adding a limited set of new metrics to enhance compliance efficiencies.[27] In addition, the agencies requested comment on whether some or all of the reported quantitative measurements should be made publically available.

The agencies invited comment on all aspects of the proposal, including specific proposed revisions and questions posed by the agencies. The agencies received over 75 unique comments from banking entities and industry groups, public interest groups, and other organizations and individuals. In addition, the agencies received approximately 3,700 comments from individuals using a version of a short form letter to express opposition to the proposed rule. For the reasons discussed below, the agencies are now adopting a final rule that incorporates a number of modifications.

III. Overview of the Final Rule and Modifications From the Proposal

A. The Final Rule

Similar to the proposal, the final rule includes a risk-based approach to revising the 2013 rule that relies on a set of clearly articulated standards for both prohibited and permitted activities and investments. The final rule is intended to further tailor and simplify the rule to allow banking entities to more efficiently provide financial services in a manner that is consistent with the requirements of section 13 of the BHC Act.

The comments the agencies received from banking entities and financial services industry trade groups were generally supportive of the proposal, with the exception of the proposed accounting prong, and provided recommendations for further targeted changes. The agencies also received a few comments in opposition to the proposal from various organizations and individuals.[28] As described further below, the agencies have adopted many of the proposed changes to the 2013 rule, with certain targeted adjustments based on comments received. Furthermore, the agencies intend to issue an additional notice of proposed rulemaking that would propose additional, specific changes to the restrictions on covered fund investments and activities and other issues related to the treatment of investment funds under the regulations implementing section 13 of the BHC Act.

The final rule includes the same general three-tiered approach to tailoring the compliance program requirements as the proposal. However, based on comments received, the agencies have modified the threshold for banking entities in the ''significant'' compliance category from $10 billion in gross trading assets and liabilities to $20 billion in gross trading assets and liabilities. The final rule also includes modifications to the calculation of trading assets and liabilities for purposes of determining which compliance tier a banking entity falls into by excluding certain financial instruments that banking entities are permitted to trade without limit under section 13. Additionally, the final rule aligns the methodologies for calculating the ''limited'' and ''significant'' compliance thresholds for foreign banking organizations by basing both thresholds on the trading assets and liabilities of the firm's U.S. operations.[29]

The final rule also includes many of the proposed changes to the proprietary trading restrictions, with certain changes based on comments received. One such change is that the final rule does not include the proposed accounting prong in the trading account definition. Instead, the final rule retains a modified version of the short-term intent prong and replaces the 2013 rule's rebuttable presumption that financial instruments held for fewer than 60 days are within the short-term intent prong of the trading account with a rebuttable presumption that financial instruments held for 60 days or longer are not within the short-term intent prong of the trading account. The final rule also provides that a banking entity that is subject to the market risk capital rule prong of the trading account definition is not also subject to the short-term intent prong, and a banking entity that is not subject to the market risk capital rule prong may elect to apply the market risk capital rule prong (as an alternative to the short-term intent prong). Additionally, the final rule modifies the liquidity management exclusion from the proprietary trading restrictions to permit banking entities to use a broader range of financial instruments to manage liquidity, and it adds new exclusions for error trades, certain customer-driven swaps, hedges of mortgage servicing rights, and purchases or sales of instruments that do not meet the definition of trading assets or liabilities. Furthermore, the final rule revises the trading desk definition to provide more flexibility to banking entities to align the definition with other trading desk definitions in existing or planned compliance programs. This modified definition also will provide for consistent treatment across different regulatory regimes.

The final rule also includes the proposed changes to the exemptions from the prohibitions in section 13 of the BHC Act for underwriting and market making-related activities, risk-mitigating hedging, and trading by foreign banking entities solely outside the United States. The final rule also includes the proposed changes to the covered funds provisions for which specific rule text was proposed, including with respect to permitted underwriting and market making and risk-mitigating hedging with respect to a covered fund, as well as investment in or sponsorship of covered funds by foreign banking entities solely outside the United States and the exemption for prime brokerage transactions. With respect to the exemptions for underwriting and market making-related activities, the final rule adopts the presumption of compliance with the

[23] *See* 83 FR 33487–89; 33490–94.

[24] *See* 83 FR 33489.

[25] *See* 83 FR 33490.

[26] *See* 83 FR 33454.

[27] *See* 83 FR 33494–514.

[28] *See, e.g.,* Senators Merkley et al.; Elise J. Bean (Bean); National Association of Federally-Insured Credit Unions (NAFCU); Better Markets, Inc. (Better Markets); Americans for Financial Reform (AFR); Volcker Alliance; Occupy the SEC; and Volcker 2.0 Form Letter.

[29] Under the proposal, the ''limited'' compliance threshold would have been based on the trading assets and liabilities of a foreign banking organization's worldwide operations whereas the ''significant'' compliance threshold would have been based on the trading assets and liabilities of a foreign banking organization's U.S. operations.

reasonably expected near-term demand requirement for trading within certain internal limits, but instead of requiring banking entities to promptly report limit breaches or increases to the agencies, banking entities are required to maintain and make available upon request records of any such breaches or increases and follow certain internal escalation and approval procedures in order to remain qualified for the presumption of compliance.

With respect to the compliance program requirements, the final rule includes the changes from the proposal to eliminate the enhanced compliance requirements in Appendix B of the 2013 rule and to tailor the compliance program requirements based on the size of the banking entity's trading activity. However, different from the proposal, the final rule only applies the CEO attestation requirement to firms with significant trading assets and liabilities. Also, in response to comments, the final rule includes modifications to the metrics collection requirements to, among other things, eliminate certain metrics and reduce the compliance burden associated with the requirement.

For the OCC, Board, FDIC, and CFTC, the final amendments will be effective on January 1, 2020. For the SEC, the final amendments will be effective on January 13, 2020. In order to give banking entities a sufficient amount of time to comply with the changes adopted, banking entities will not be required to comply with the final amendments until January 1, 2021. During that time, the 2013 rule will remain in effect as codified in appendix Z, which is a temporary appendix that will expire on the compliance date. However, banking entities may voluntarily comply, in whole or in part, with the amendments adopted in this release prior to the compliance date, subject to the agencies' completion of necessary technical changes. In particular, the agencies need to complete certain technological programming in order to accept metrics compliant with the final amendments. The agencies will conduct a test run with banking entities of the revised metrics submission format. A banking entity seeking to switch to the revised metrics prior to January 1, 2021, must first successfully test submission of the revised metrics in the new XML format. Accordingly, banking entities should work with each appropriate agency to determine how and when to voluntarily comply with the metrics requirements under the final rules and to notify such agencies of their intent to comply, prior to the January 1, 2021, compliance date.

B. Interagency Coordination and Other Comments

Section 13(b)(2)(B)(ii) of the BHC Act directs the agencies to "consult and coordinate" in developing and issuing the implementing regulations "for the purpose of assuring, to the extent possible, that such regulations are comparable and provide for consistent application and implementation of the applicable provisions of [section 13 of the BHC Act] to avoid providing advantages or imposing disadvantages to the companies affected . . . ." [30] The agencies recognize that coordinating with each other to the greatest extent practicable with respect to regulatory interpretations, examinations, supervision, and sharing of information is important to maintaining consistent oversight, promoting compliance with section 13 of the BHC Act and implementing regulations, and to fostering a level playing field for affected market participants. The agencies further recognize that coordinating these activities helps to avoid unnecessary duplication of oversight, reduces costs for banking entities, and provides for more efficient regulation.

In the proposal, the agencies requested comment on interagency coordination regarding the Volcker Rule in general and asked several specific questions relating to transparency, efficiency, and safety and soundness.[31] Numerous commenters, including banking entities and industry groups, suggested that the agencies more effectively coordinate Volcker Rule related supervision, examinations, and enforcement, in order to improve efficiency and predictability in supervision and oversight.[32] For example, several commenters suggested that Volcker Rule related supervision should be conducted solely by a bank's prudential onsite examiner,[33] and that the two market regulators be required to consult and coordinate with the prudential onsite examiner.[34] Several commenters encouraged the agencies to memorialize coordination and information sharing between the agencies by entering into a formal written agreement, such as an interagency Memorandum of Understanding.[35]

Several comment letters from public interest organizations suggested that the agencies have not provided sufficient transparency when implementing and enforcing the Volcker Rule, and urged the agencies to make public certain information related to enforcement actions, metrics, and covered funds activities.[36] In addition, several commenters, including a member of Congress, argued that the agencies have not adequately explained or provided evidence to support the current rulemaking.[37]

The agencies agree with commenters that interagency coordination plays an important role in the effective implementation and enforcement of the Volcker Rule, and acknowledge the benefits of providing transparency in proposing and adopting rules to implement section 13 of the BHC Act. Accordingly, the agencies have endeavored to provide specificity and clarity in the final rule to avoid conflicting interpretations or uncertainty. The final rule also includes notice and response procedures that provide a greater degree of certainty about the process by which the agencies will make certain determinations under the final rule. The agencies continue to recognize the benefits of consistent application of the rules implementing section 13 of the BHC Act and intend to continue to consult with each other when formulating guidance on the final rule that would be shared with the public generally. That said, the agencies also are mindful of the need to strike an appropriate balance between public disclosure and the protection of sensitive, confidential information, and the agencies are generally restricted from disclosing sensitive, confidential business and supervisory information on a firm-specific basis.

Several commenters provided general comments regarding the proposal and the current rulemaking. For example, several public interest commenters suggested that the proposed rule did not provide a sufficient financial disincentive against proprietary trading and encouraged the agencies to adopt certain limitations on compensation arrangements.[38] A commenter also suggested possible penalties for rule violations and encouraged the agencies to elaborate on the consequences of

[30] 12 U.S.C. 1851(b)(2)(B)(ii).

[31] 83 FR 33436.

[32] *See, e.g.,* American Bankers Association (ABA); Institute of International Bankers (IIB); BB&T; Committee on Capital Markets Regulation (CCMR); Japanese Bankers Association (JBA); and the CFA Institute (CFA). Commenters also recommended designating to one agency the task of interpreting the implementing regulations and issuing guidance to smaller banking entities. *See, e.g.,* Credit Suisse and Lori Nuckolls.

[33] *See, e.g.,* ABA; Arvest Bank (Arvest); Credit Suisse; and Financial Services Forum (FSF).

[34] *See* ABA.

[35] *See, e.g.,* ABA; BB&T; CCMR; and FSF.

[36] *See, e.g.,* AFR; Public Citizen; Volcker Alliance; and CFA.

[37] *See, e.g.,* CAP; Merkley; and Public Citizen.

[38] *See, e.g.,* Public Citizen and CAP.

significant violations of the rule.[39] Other commenters recommended that the agencies impose strong penalties on banking entities that break the law.[40] The agencies believe that the appropriate consequences for a violation of the rule will likely depend on the specific facts and circumstances in individual cases, as well as each agency's statutory authority under section 13, and therefore are not amending the rule to provide for specific penalties or financial disincentives for violations. Finally, several commenters suggested that the proposed rule is too complex and may provide too much deference to a banking entity's internal procedures and models (for example, in provisions related to underwriting, market making, and hedging), and that the proposed revisions would make the rule less effective.[41] As discussed further below, the agencies believe that the particular changes adopted in the final rule are meaningfully simpler and streamlined compared to the 2013 rule, and are appropriate for the reasons described in greater detail below.

IV. Section by Section Summary of the Final Rule

A. Subpart A – Authority and Definitions

1. Section ▮▮.2: Definitions

a. Banking Entity

Section 13(a)(1)(A) of the BHC Act prohibits a banking entity from engaging in proprietary trading or acquiring or retaining an ownership interest, or sponsoring, a covered fund, unless the activity is otherwise permissible under section 13.[42] Therefore, the definition of the term ''banking entity'' defines the scope of entities subject to restrictions under the rule. Section 13(h)(1) of the BHC Act defines the term ''banking entity'' to include (i) any insured depository institution (as defined by statute); (ii) any company that controls an insured depository institution; (iii) any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978; and (iv) any affiliate or subsidiary of any such entity.[43] The regulations implementing this provision are consistent with the statute and also exclude covered funds that are not themselves banking entities, certain portfolio companies, and the FDIC acting in its corporate capacity as conservator or receiver.[44]

In addition, the agencies note that, consistent with the statute, for purposes of this definition, the term ''insured depository institution'' does not include certain institutions that function solely in a trust or fiduciary capacity, and certain community banks and their affiliates.[45] Section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) amended the definition of ''banking entity'' in the Volcker Rule to exclude certain community banks from the definition of insured depository institution, the general result of which was to exclude community banks and their affiliates and subsidiaries from the scope of the Volcker Rule.[46] On July 22, 2019, the agencies adopted a final rule amending the definition of ''insured depository institution,'' in a manner consistent with EGRRCPA.[47]

The proposed rule did not propose specific rule text to amend the definition of ''banking entity,'' but invited comment on a number of specific issues.[48] The agencies received several comments about the ''banking entity'' definition, many of which asked that the agencies revise this definition to exclude specific types of entities.

Several commenters expressed concern about the treatment of certain funds that are excluded from the definition of ''covered fund'' in the 2013 rule, including registered investment companies (RICs), foreign public funds (FPFs), and, with respect to a foreign banking entity, certain foreign funds offered and sold outside of the United States (foreign excluded funds).[49] In particular, these commenters noted that when a banking entity invests in such funds, or has certain corporate governance rights or other control rights with respect to such funds, the funds could meet the definition of ''banking entity'' for purposes of the Volcker Rule.[50] Concerns about certain funds' potential status as banking entities arise, in part, because of the interaction between the statute's and the 2013 rule's definitions of the terms ''banking entity'' and ''covered fund.'' Sponsors of RICs, FPFs, and foreign excluded funds have noted that the treatment of such funds as ''banking entities'' would disrupt bona fide asset management activities (including fund investment strategies that may include proprietary trading or investing in covered funds), which these sponsors argued would be inconsistent with section 13 of the BHC Act.[51] Commenters also noted that treatment of RICs, FPFs, and foreign excluded funds as ''banking entities'' would put such banking entity-affiliated funds at a competitive disadvantage compared to funds not affiliated with a banking entity, and therefore not subject to restrictions under section 13 of the BHC Act.[52] In general, commenters also asserted that the treatment of RICs, FPFs, and foreign excluded funds as banking entities would not further the policy objectives of section 13 of the BHC Act.[53]

Several commenters suggested that the agencies exclude from the definition of ''banking entity'' foreign excluded funds.[54] These commenters generally noted that failing to exclude such funds from the definition of ''banking entity'' in the 2013 rule has the unintended consequence of imposing proprietary trading restrictions and compliance obligations on foreign excluded funds that are in some ways more burdensome than the requirements that would apply under the 2013 rule to covered funds. Another commenter expressed opposition to carving out foreign excluded funds from the definition of banking entity.[55] The staffs of the agencies continue to consider ways in which the regulations may be amended in a manner consistent with the statutory definition of ''banking entity,'' or other appropriate actions that may be taken, to address any unintended consequences of section 13 of the BHC Act and the 2013 rule. The agencies intend to issue a separate proposed

[39] *See* Public Citizen.

[40] *See* Volcker 2.0 Form Letter.

[41] *See, e.g.,* Systemic Risk Council and Oonagh McDonald.

[42] 12 U.S.C. 1851(a)(1)(A). A banking entity may engage in an activity that is permissible under section 13 of the BHC Act only to the extent permitted by any other provision of Federal and State law, and subject to other applicable restrictions. *See* 12 U.S.C. 1851(d)(1).

[43] 12 U.S.C. 1851(h)(1).

[44] *See* 2013 rule § ▮▮.2(c).

[45] *See* final rule § ▮▮.2(r).

[46] Public Law 115–174 (May 24, 2018).

[47] *See* 84 FR 35008.

[48] *See* 83 FR 33442–446.

[49] *See, e.g.,* ABA; American Investment Council (AIC); Bundesverband Investment (BVI); Canadian Bankers Association (CBA); European Banking Federation (EBF); Federated Investors II; Financial Services Agency and Bank of Japan (FSA/Bank of Japan); European Fund and Asset Management Association (EFAMA); and IIB.

[50] *Id.*

[51] *See, e.g.,* IIB and Securities Industry and Financial Markets Association (SIFMA).

[52] *See, e.g.,* Capital One et al.; Credit Suisse; EBF; and Investment Adviser Association (IAA).

[53] *See, e.g.,* ABA; EBF; and Investment Company Institute (ICI).

[54] *Id.* In addition to the requests from commenters for the agencies to exclude foreign excluded funds from the ''banking entity'' definition, commenters also asked the agencies to adopt other amendments to address the treatment of such funds, including by providing a presumption of compliance for such funds (CBA; EBF; and IIB), to permit a banking entity to elect to treat a foreign excluded fund as a covered fund (CBA; EBF; and IIB), and to permanently extend the temporary relief currently provided to foreign excluded funds (IIB).

[55] *See* Data Boiler Technologies, LLC (Data Boiler).

rulemaking that specifically addresses the fund structures under the rule, including the treatment of foreign excluded funds.

To provide additional time to complete this rulemaking, the Federal banking agencies released a policy statement on July 17, 2019, in response to concerns about the treatment of foreign excluded funds. This policy statement provides that the Federal banking agencies would not propose to take action during the two-year period ending on July 21, 2021, against a foreign banking entity based on attribution of the activities and investments of a qualifying foreign excluded fund to the foreign banking entity,[56] or against a qualifying foreign excluded fund as a banking entity, in each case where the foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, the qualifying foreign excluded fund would meet the requirements for permitted covered fund activities and investments solely outside the United States, as provided in section 13(d)(1)(I) of the BHC Act and § ▮ ▮.13(b) of the 2013 rule, as if the qualifying foreign excluded fund were a covered fund.[57]

Several commenters expressed concern with the treatment of RICs and FPFs, which are subject to significant regulatory requirements in the United States and foreign jurisdictions, respectively. These commenters encouraged the agencies to consider excluding such entities from the definition of ''banking entity.'' [58] In the past, the staffs of the agencies issued several FAQs to address the treatment of RICs and FPFs.[59] One of these staff FAQs provides guidance about the treatment of RICs and FPFs during the period in 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).[60] Another FAQ stated that staffs of the agencies would not view the activities and investments of an FPF that meets certain eligibility requirements in the 2013 rule as being attributed to the banking entity for purposes of section 13 of the BHC Act or the 2013 rule, where the banking entity (i) does not own, control, or hold with the power to vote 25 percent or more of any class of voting shares of the FPF (after the seeding period), and (ii) provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with applicable limitations in the relevant foreign jurisdiction. Similarly, this FAQ stated that the staffs of the agencies would not view the FPF to be a banking entity for purposes of section 13 of the BHC Act and the 2013 rule solely by virtue of its relationship with the sponsoring banking entity, where these same conditions are met.[61]

As noted above, the agencies intend to issue a separate proposal addressing and requesting comment on the covered fund provisions and other fund-related issues. The final rule does not modify or revoke any previously issued staff FAQs or guidance related to RICs, FPFs, and foreign excluded funds.[62]

Apart from these topics, the agencies received numerous other comments about the treatment of entities as ''banking entities'' under section 13 of the BHC Act. In general, these commenters requested that the agencies provide additional exclusions from the definition of ''banking entity'' for various types of entities. One commenter suggested that, as an alternative to excluding certain entities from the banking entity definition, the agencies could exempt the activities of these entities from the proprietary trading and covered fund prohibitions.[63]

One commenter recommended that the agencies provide a general exemption from the banking entity definition for investment funds, except in circumstances where the investment fund is determined to have been organized to permit the banking entity sponsor to engage in impermissible proprietary trading.[64] Some commenters encouraged the agencies to exclude employee securities companies from the definition of ''banking entity.'' [65] One commenter argued that despite a banking entity's role as a general partner in employee securities companies, treating such entities as ''banking entities'' does not further the policy goals of section 13 of the BHC Act.[66] Several commenters encouraged the agencies to exclude from the definition of ''banking entity'' any non-consolidated subsidiaries not operated or managed by a banking entity, on the basis that such entities were never intended to be subject to section 13 of the BHC Act.[67] Another commenter said the agencies should exclude from the definition of ''banking entity'' all employee compensation plans, regardless of whether such plans are qualified or non-qualified.[68] Other commenters suggested that the agencies should exclude subsidiaries of foreign banking entities that do not engage in trading activities in the United States, or otherwise limit application to foreign subsidiaries of foreign banking groups.[69] Other commenters requested modification of the definition of ''banking entity'' to exclude parent companies and affiliates of industrial loan companies, noting that such companies are generally not subject to other restrictions on their activities under the BHC Act.[70]

One commenter encouraged the agencies to exclude international banks from the definition of ''banking entity'' if they have limited U.S. trading assets and liabilities.[71] This commenter also

[56] Foreign banking entity was defined for purposes of the policy statement to mean a banking entity that is not, and is not controlled directly or indirectly by, a banking entity that is located in or organized under the laws of the United States or any State.

[57] *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, ''Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act'' (July 17, 2019). This policy statement continued the position of the Federal banking agencies that was released on July 21, 2017, and the position that the agencies expressed in the proposal. *See* 83 FR 33444.

[58] *See, e.g.,* CCMR; IAA; ICI; and Capital One et al. One commenter also expressed support for a narrower exclusion for RICs and FPFs that would apply only during a non-time-limited seeding period. JP Morgan Asset Management.

[59] *See https://www.occ.treas.gov/topics/capitalmarkets/financial-markets/trading-volcker-rule/volcker-rule-implementation-faqs.html* (OCC); *https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm* (Board); *https://www.fdic.gov/regulations/reform/volcker/faq.html* (FDIC); *https://www.sec.gov/divisions/marketreg/faq-volcker-rulesection13.htm* (SEC); *https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_28_VolckerRule/index.htm* (CFTC).

[60] *Id.,* FAQ 16.

[61] *Id.,* FAQ 14.

[62] The FAQs represent the views of staff of the agencies. They are not rules, regulations, or statements of the agencies. Furthermore, the agencies have neither approved nor disapproved their content. The FAQs, like all staff guidance, have no legal force or effect: They do not alter or amend applicable law, and they create no new or additional obligations for any person.

[63] *See* Bank Policy Institute (BPI).

[64] *See* EFAMA.

[65] *See, e.g.,* ABA and FSF.

[66] *See* ABA.

[67] *See, e.g.,* ABA; BPI; SIFMA; JBA.

[68] *See* BB&T.

[69] *See* JBA. This commenter suggested that in the absence of an exclusion for such entities, simplified compliance program requirements should apply to foreign subsidiaries of foreign banking entities that do not engage in trading activities in the United States. The agencies believe that several of the other changes in this final rule will provide relief to foreign banking entities that engage in no trading activities in the United States, including simplifications to the exemption for foreign banking entities engaged in trading outside of the United States, and more tailored compliance program requirements. *See also* FSA/Bank of Japan; IIB.

[70] *See, e.g.,* EnerBank USA (EnerBank); Marketplace Lending Association; National Association of Industrial Bankers.

[71] *See* IIB. This commenter also proposed modifying the manner in which ''banking entity''

Continued

encouraged the agencies to exclude certain non-U.S. commercial companies that are comparable to U.S. merchant banking portfolio companies.[72] This commenter argued that excluding these entities would not pose material risks to the financial stability of the United States.

Some commenters suggested that the agencies should clarify the standards for what constitutes ''control'' in the context of determining whether an entity is an ''affiliate'' or ''subsidiary'' for purposes of the definition of ''banking entity'' in the Volcker Rule.[73] One commenter suggested that the definition of ''banking entity'' should include only a company in which a banking entity owns, controls, or has the power to vote 25 percent or more of a class of voting securities of the company.[74]

The definition of ''banking entity'' in section 13 of the BHC Act uses the definition of control in section 2 of the BHC Act.[75] Under the BHC Act, ''control'' is defined by a three-pronged test. A company has control over another company if the first company (i) directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other company; (ii) controls in any manner the election of a majority of the directors of the other company; or (iii) directly or indirectly exercises a controlling influence over the management or policies of the other company.[76] The Board recently issued a proposed rulemaking that would clarify the standards for evaluating whether one company exercises a controlling influence over another company for purposes of the BHC Act.[77]

The final rule does not amend the definition of banking entity. Commenters raised important considerations with respect to the consequences of the current ''banking entity'' definition under section 13 of the BHC Act and the 2013 rule. The agencies believe that other amendments to the requirements of the regulations implementing the Volcker Rule may address some of the issues raised by commenters. Certain concerns raised by commenters may need to be addressed through amendments to section 13 of the BHC Act.[78] In addition, as noted above, the agencies intend to revisit the fund-related provisions of the Volcker Rule in a separate rulemaking.

b. Limited, Moderate, and Significant Trading Assets and Liabilities

The proposal would have established three categories of banking entities based on their level of trading activity, as measured by the average gross trading assets and liabilities of the banking entity and its subsidiaries and affiliates (excluding obligations of or guaranteed by the United States or any agency of the United States) over the previous four consecutive quarters.[79] These categories would have been used to calibrate compliance requirements for banking entities, with the most stringent compliance requirements applicable to those with the greatest level of trading activities.

The first category would have included firms with ''significant'' trading assets and liabilities, defined as those banking entities that have consolidated trading assets and liabilities equal to or exceeding $10 billion.[80] The second category would have included firms with ''moderate'' trading assets and liabilities, which would have included those banking entities that have consolidated trading assets and liabilities of $1 billion or more, but with less than $10 billion in consolidated trading assets and liabilities.[81] The final category would have included firms with ''limited'' trading assets and liabilities, defined as those banking entities that have less than $1 billion in consolidated trading assets and liabilities.[82] The proposal would have also provided the agencies with a reservation of authority to require a banking entity with limited or moderate trading assets and liabilities to apply the compliance program requirements of a higher compliance tier if an agency determined that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of the requirements of the rule, warranted such treatment.[83] The proposal also solicited comment as to whether there should be further tailoring of the thresholds for a banking entity that is an affiliate of another banking entity with significant trading assets and liabilities, if that entity generally operates on a basis that is separate and independent from its affiliates and parent companies.[84]

Commenters provided feedback on multiple aspects of the tiered compliance framework, including the level of the proposed thresholds between the categories ($1 billion and $10 billion in trading assets and liabilities), the manner in which ''trading assets and liabilities'' should be measured, and alternative approaches that commenters believed would be preferable to the proposed three-tiered compliance framework. As described further below, after consideration of the comments received, the agencies are adopting a three-tiered compliance framework that is consistent with the proposal, with targeted adjustments to further tailor compliance program requirements based on the level of a firm's trading activities, and in light of concerns raised by commenters.[85] The agencies believe that this approach will increase compliance efficiencies for all banking entities relative to the 2013 rule and the proposal, and will further reduce compliance costs for firms that have little or no activity subject to the prohibitions and restrictions of section 13 of the BHC Act.

Several commenters expressed support for the proposed three-tiered compliance framework in the proposal.[86] One commenter noted that the 2013 rule's compliance regime, which imposes significant compliance obligations on all banking entities with $50 billion or more in total consolidated assets, does not appropriately tailor compliance obligations to the scope of activities covered under the regulation, particularly for firms engaged in limited trading activities.[87] Other commenters expressed general opposition to the proposed three-tiered compliance program.[88] Another commenter expressed concern in particular that banking entities with ''limited'' trading assets and liabilities would have been presumed compliant with the requirements of section 13 of the BHC

status is determined by disaggregating separate, independent corporate groups.

[72] *Id.*

[73] *See, e.g.,* EnerBank and Capital One et al. *See* 12 U.S.C. 1841(a)(2)(C).

[74] *See* Capital One et al.

[75] 12 U.S.C. 1841(a)(2); 12 CFR 225.2(e).

[76] *Id.*

[77] *See* ''Control and Divestiture Proceedings,'' 84 FR 21634–666 (May 14, 2019).

[78] *See, e.g.,* Economic Growth, Regulatory Relief, and Consumer Protection Act § 203 (excluding community banks from the definition of ''banking entity'').

[79] *See* proposed rule § ■■.2(t), (v), (ff). Under the proposal, a foreign banking entity's trading assets and liabilities would have been calculated based on worldwide trading assets and liabilities with respect to the $1 billion threshold between limited and moderate trading assets and liabilities, but based on the trading assets and liabilities only of its combined U.S. operations with respect to the $10 billion threshold between moderate and significant trading assets and liabilities. *See* proposed rule § ■■.2(t)(1), (ff)(2)–(3).

[80] Proposed rule § ■■.2(ff).

[81] Proposed rule § ■■.2(v).

[82] Proposed rule § ■■.2(t).

[83] Proposed rule § ■■.20(h).

[84] *See* 83 FR at 33442 (question 7).

[85] *See* final rule § ■■.2(s), (u), (ee).

[86] *See, e.g.,* BB&T Corporation; CFA; CCMR; and State Street Corporation (State Street).

[87] *See* State Street.

[88] *See, e.g.,* Bean; Data Boiler Technologies; and Occupy the SEC.

Act under the proposed rule.[89] Some commenters also suggested that the agencies adopt a two-tiered compliance program, bifurcating banking entities into those with and without significant trading assets and liabilities.[90] One commenter expressed opposition to tailoring compliance requirements for banking entities that operate separately and independently from their affiliates, by calculating trading assets and liabilities for such entities independent of the activities of affiliates.[91] The agencies believe that the three-tiered framework set forth in the proposal, subject to the additional amendments described below, appropriately differentiates among banking entities for the purposes of tailoring compliance requirements. Specifically, the agencies believe that the significant differences in business models and activities among banking entities that would have significant trading assets and liabilities, moderate trading assets and liabilities, and limited trading assets and liabilities, as described below, support having a three-tiered compliance framework.

A few commenters recommended that the agencies raise the proposed $1 billion threshold between banking entities with limited and moderate trading assets and liabilities.[92] These commenters suggested that raising this threshold to $5 billion in trading assets and liabilities would be consistent with the objective of the proposal to have the most streamlined requirements imposed on banking entities with a relatively small amount of trading activities. Other commenters recommended that the threshold between banking entities with limited and moderate trading activities was appropriate or should be set at a lower level.[93] The agencies believe that the compliance obligations applicable to banking entities with limited trading assets and liabilities are most appropriately reserved for banking entities below the $1 billion threshold set forth in the proposal. Such banking entities tend to have simpler business models and do not have large trading operations that would warrant the expanded compliance obligations applicable to banking entities with moderate and significant trading assets and liabilities. As discussed further below, these banking entities also hold a relatively small amount of the trading assets and liabilities in the U.S. banking system. Therefore, the final rule adopts the threshold from the proposed rule for determining whether a banking entity has limited trading assets and liabilities.[94]

Several commenters recommended that the agencies modify the threshold for ''significant'' trading assets and liabilities.[95] Generally, these commenters expressed support for raising the threshold from $10 billion in trading assets and liabilities to $20 billion in trading assets and liabilities.[96] These commenters noted that this change would have minimal impact on the number of banking entities that would remain categorized as having significant trading assets and liabilities.[97] Several commenters also noted that increasing the threshold from $10 billion to $20 billion would provide additional certainty to banking entities that are near or approaching the $10 billion threshold, because market events or unusual customer demands could cause such banking entities to exceed (permanently or on a short-term basis) the $10 billion trading assets and liabilities threshold.[98] The final rule adopts the change recommended by several commenters to raise the threshold from $10 billion to $20 billion for calculating whether a banking entity has significant trading assets and liabilities.[99]

The agencies estimate that, under the final rule with the increased threshold from $10 billion to $20 billion described above, banking entities classified as having significant trading assets and liabilities would hold approximately 93 percent of the trading assets and liabilities in the U.S. banking system. The agencies also estimate that banking entities with significant trading assets and liabilities and those with moderate trading assets and liabilities in combination would hold approximately 99 percent of the trading assets and liabilities in the U.S. banking system. Therefore, both of these thresholds will tailor the compliance obligations under the final rule for all firms by virtue of imposing greater compliance obligations on those banking entities with the most substantial levels of trading activities.

One commenter suggested that the agencies index the compliance tier thresholds to inflation.[100] At present, the agencies do not believe that the additional complexity associated with inflation-indexing the thresholds in the final rule is necessary in light of the other changes to the thresholds and calculation methodologies described below, including the increase in the threshold for firms with significant trading assets and liabilities from $10 billion to $20 billion, and the modifications to the calculation of trading assets and liabilities adopted in the final rule.[101]

Commenters recommended that the regulations incorporate a number of changes to the methodology used in the proposed rule to classify firms into different compliance tiers. Some commenters recommended that the agencies apply a consistent methodology to foreign banking entities to classify such firms as having significant trading assets and liabilities, moderate trading assets and liabilities, or limited trading assets and liabilities.[102] For purposes of classifying the banking entity as having significant trading assets and liabilities, the proposal would have included only the trading assets and liabilities of the combined U.S. operations of a foreign banking entity, but used the banking entity's worldwide trading assets and liabilities for purposes of classifying the firm as having either limited trading assets and liabilities or moderate trading assets and liabilities.[103] Commenters recommended that the agencies apply a consistent standard for classifying a foreign banking entity as having significant trading assets and liabilities, moderate trading assets and liabilities, or limited trading assets and liabilities, and that the most appropriate measure would look only at the combined U.S. operations of such a banking entity.[104] These commenters noted that classifying foreign banking entities based on their global trading activities could have the result of imposing extensive compliance obligations on the non-U.S. trading activities of a banking entity with minimal U.S. trading activities.[105]

The final rule adopts a consistent methodology for calculating the trading assets and liabilities of foreign banking entities across all categories, taking into account only the trading assets and

[89] *See* Occupy the SEC.

[90] *See, e.g.,* ABA; Capital One et al.; and KeyCorp and KeyBank (KeyCorp).

[91] *See* Data Boiler Technologies.

[92] *See, e.g.,* ABA; Capital One et al.; and BPI.

[93] *See, e.g.,* Data Boiler (encouraging the agencies to lower the threshold to $500 million in trading assets and liabilities) and B&F Capital Markets (B&F) (expressing support for the proposed $1 billion threshold).

[94] *See* final rule § ■■.2(s)(2)–(3).

[95] *See, e.g.,* ABA; Bank of New York Mellon Corporation, Northern Trust Corporation, and State Street Corporation (Custody Banks); New England Council; Capital One et al.; SIFMA; State Street; and BPI.

[96] *Id.*

[97] *Id.*

[98] *See, e.g.,* ABA; Capital One et al.; and SIFMA.

[99] *See* final rule § ■■.2(ee)(1)(i).

[100] *See* Capital One et al.

[101] *See, e.g.,* final rule § ■■.2(ee)(1)(i).

[102] *See, e.g.,* IIB and JBA.

[103] *See* proposed rule § ■■.2(t)(1), (ff)(2)–(3).

[104] *See, e.g.,* IIB and JBA.

[105] *Id.*

liabilities of such banking entities' combined U.S. operations.[106] The agencies believe this approach is appropriate, particularly for foreign firms with little or no U.S. trading activity but substantial worldwide trading operations. The agencies further believe that the trading activities of foreign banking entities that occur outside of the United States and are booked into such foreign banking entities (or into their foreign affiliates), pose substantially less risk to the U.S. financial system than trading activities booked into a U.S. banking entity, including a U.S. banking entity that is an affiliate of a foreign banking entity. This approach is also appropriate in light of provisions in section 13 of the BHC Act that provide foreign banking entities with significant flexibility to conduct trading and covered fund activities outside of the United States.[107]

One commenter expressed concern that the regulations did not give banking entities sufficient guidance as to how to calculate their trading assets and liabilities, and asked that the regulations expressly permit a banking entity to rely on home jurisdiction accounting standards when calculating trading assets and liabilities.[108] In light of the changes to the methodology for calculating trading assets and liabilities noted above, in particular using combined U.S. trading assets and liabilities for establishing the appropriate compliance tier for foreign banking entities, the agencies believe that further clarifications to the standards for calculating ''trading assets and liabilities'' are not necessary for banking entities to have sufficient information available as to the manner in which to calculate trading assets and liabilities.

A few commenters suggested that the threshold for ''significant trading assets and liabilities'' should be determined based on the relative size of the banking entity's total trading assets and liabilities as compared to other metrics, such as total consolidated assets or capital, thereby establishing a banking entity's compliance requirements based on the significance of trading activities to the banking entity.[109] Some commenters suggested that the use of trading assets and liabilities alone as a metric to classify banking entities for determining compliance obligations was inappropriate.[110] The agencies believe that a banking entity's trading assets and liabilities, as calculated under the methodology described in the final rule, is an appropriate metric to use in establishing compliance requirements for banking entities. Imposing compliance obligations on a banking entity based on the relative significance of trading activities to the firm could have the result of imposing fewer compliance obligations on a larger banking entity with identical trading activities to a smaller counterpart, simply because of that entity's larger size.

Several commenters recommended that the regulations exclude particular types of trading assets and liabilities for purposes of determining whether a banking entity has significant trading assets and liabilities, moderate trading assets and liabilities, or limited trading assets and liabilities. In particular, some commenters encouraged the agencies to exclude all government obligations and other assets and liabilities that are not subject to the prohibition on proprietary trading under section 13 of the BHC Act and the regulations.[111] The final rule modifies the methodology for calculating a firm's trading assets and liabilities to exclude all financial instruments that are obligations of, or guaranteed by, the United States, or that are obligations, participations, or other instruments of or guaranteed by an agency of the United States or a government-sponsored enterprise as described in the regulations.[112] As commenters noted, banking entities are permitted to engage in trading activities in these products under section 13 of the BHC Act and the implementing regulations, and therefore the exclusion of such instruments for the final rule will result in a more appropriately tailored standard than under the proposal. The agencies also believe that the calculation of trading assets and liabilities, subject to these modifications, should continue to be relatively simple for banking entities and the agencies, without requiring the imposition of additional reporting requirements.

A few commenters recommended that certain *de minimis* risk portfolios, such as matched derivatives holdings and loan-related swaps, be excluded from the calculation of trading assets and liabilities.[113] Another commenter recommended the calculation of trading assets and liabilities should exclude insurance assets.[114] Another commenter proposed that the trading assets and liabilities of non-consolidated affiliates be excluded, because tracking the trading assets and liabilities of such subsidiaries on an ongoing basis may present significant practical burdens.[115] As discussed herein, the final rule makes several amendments to the methodology for calculating trading assets and liabilities, for example by excluding securities issued or guaranteed by certain government-sponsored enterprises, and by calculating trading assets and liabilities for foreign banking entities based only on the combined U.S. operations of such banking entities.[116] The agencies believe that the revisions in the final rule should simplify the manner in which a banking entity calculates its trading assets and liabilities. However, the final rule does not adopt the changes recommended by a few commenters to exclude trading assets and liabilities associated with particular business activities or business lines, other than the express modifications noted above, or to exclude the trading assets and liabilities of certain types of subsidiaries. Rather, the final rule adopts an approach that is intended to be straightforward and consistent and allow banking entities greater ability to leverage regulatory reports that banking entities are already required to prepare under existing law, such as the Form Y9–C and the Call Report.[117]

Some commenters noted that the regulations should clarify the manner in which a banking entity should calculate trading assets and liabilities, and make clear whether it would be appropriate to rely on regulatory reporting forms such as the Board's Consolidated Financial Statements for Holding Companies, Form FR Y–9C or call report information, or other regulatory reporting forms.[118] Other commenters recommended that the agencies clarify whether the calculation of ''trading assets and liabilities'' should include only positions that would be within the scope of the ''trading account'' definition, or should otherwise exclude

[106] *See* final rule § ▮▮.2(s)(3), (ee)(3).

[107] *See* Section 13(d)(1)(H), (I) (12 U.S.C. 1851(d)(1)(H), (I)).

[108] *See* JBA.

[109] *See, e.g.,* ABA; Capital One et al.

[110] *See, e.g.,* Data Boiler and John Hoffman.

[111] *See, e.g.,* BMO Financial Group (BMO); Capital One et al.; and KeyCorp.

[112] *See* final rule § ▮▮.2(s)(2), (3); *see also* final rule § ▮▮.6(a)(1), (2).

[113] *See, e.g.,* ABA; Arvest; and BOK Financial (BOK).

[114] *See* Insurance Coalition.

[115] *See* JBA.

[116] *See* final rule § ▮▮.2(s)(2)–(3), (ee)(2)–(3).

[117] Compliance obligations are determined on a consolidated basis under the final rule. For that reason, where a banking entity has an unconsolidated subsidiary, the banking entity would not need to examine additional financial reports to determine its compliance obligations.

[118] *See, e.g.,* Bank of Oklahoma; KeyCorp; BPI; and Capital One et al Banks.

certain types of instruments.[119] The agencies support banking entities relying on current regulatory reporting forms to the extent possible to determine their compliance obligations under the final rule. As discussed above, the calculation of significant trading assets and liabilities, moderate trading assets and liabilities, and limited trading assets and liabilities is based on a four-quarter average, and therefore would not require daily or more frequent monitoring of trading assets and liabilities.[120]

A few commenters encouraged the agencies to include transition periods for a banking entity that moves to a higher compliance tier, to allow the banking entity time to comply with the different expectations under the compliance tier.[121] Some commenters said that the regulations should permit a banking entity to breach a threshold for a higher compliance category without needing to comply with the heightened compliance requirements applicable to banking entities with that level of trading assets and liabilities, provided the banking entity's trading assets and liabilities drop below the relevant threshold within a limited period of time.[122] The final rule does not adopt transition periods or cure periods as recommended by commenters. The calculation of a banking entity's trading assets and liabilities is calculated based on a 4-quarter average, which should provide banking entities with ample notice to come into compliance with the requirements of the final rule when crossing from having limited to moderate trading assets and liabilities, or from moderate to significant trading assets and liabilities.[123]

One commenter recommended that the agencies provide for notice and response procedures prior to exercising the reservation of authority to require a banking entity to apply the requirements of a higher compliance program tier, and, if a banking entity is determined to be required to apply increased compliance program requirements, it should be given a two-year conformance period to come into compliance with such requirements.[124] After considering this comment, the agencies believe that the notice and response procedures provided in the proposal for rebutting the presumption of compliance for banking entities with limited trading assets and liabilities would also be appropriate with respect to an agency exercising this reservation of authority. However, the agencies believe that providing an automatic two-year conformance period would be inappropriate, especially in instances where the agency has concerns regarding evasion of the requirements of the final rule. Therefore, the agencies are adopting the reservation of authority with a modification to require that the agencies exercise such authority in accordance with the notice and response procedures in section ■■.20(i) of the final rule.[125] To the extent that an agency exercises this authority to require a banking entity to apply increased compliance program requirements, an appropriate conformance period shall be determined through the notice and response procedures.

B. Subpart B—Proprietary Trading Restrictions

Section 13(a)(1)(A) of the BHC Act prohibits a banking entity from engaging in proprietary trading unless otherwise permitted in section 13. Section 13(h)(4) of the BHC Act defines proprietary trading, in relevant part, as engaging as principal for the trading account of the banking entity in any transaction to purchase or sell, or otherwise acquire or dispose of, a security, derivative, contract of sale of a commodity for future delivery, or other financial instrument that the agencies include by rule. Section 13(h)(6) of the BHC Act defines "trading account" to mean any account used for acquiring or taking positions in the securities and instruments described in section 13(h)(4) principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the agencies, by rule determine.[126] Section 3 of the implementing regulations defines "proprietary trading," "trading account," and several related definitions.

1. Section ■■.3: Prohibition on Proprietary Trading and Related Definitions

a. Trading Account

The 2013 rule's definition of trading account includes three prongs and a rebuttable presumption. The short-term intent prong includes within the definition of trading account the purchase or sale of one or more financial instruments principally for the purpose of (A) short-term resale, (B) benefitting from actual or expected short-term price movements, (C) realizing short-term arbitrage profits, or (D) hedging one or more positions resulting from the purchases or sales of financial instruments for the foregoing purposes.[127] Under the 2013 rule's rebuttable presumption, the purchase (or sale) of a financial instrument by a banking entity is presumed to be for the trading account under the short-term intent prong if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale). A banking entity could rebut the presumption by demonstrating, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in the short-term intent prong.[128]

The market risk capital rule prong (market risk capital prong) includes within the definition of trading account the purchase or sale of one or more financial instruments that are both covered positions and trading positions under the market risk capital rule (or hedges of other covered positions under the market risk capital rule), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule.[129]

Finally, the dealer prong includes within the definition of trading account any purchase or sale of one or more financial instruments for any purpose if the banking entity (A) is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or (B) is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in

[119] *See, e.g.,* BMO and Capital One et al.

[120] *See* final rule § ■■.2(s)(1)(i), (ee)(1)(i).

[121] *See, e.g.,* ABA; BPI; Custody Banks; Capital One et al.; and State Street.

[122] *See* State Street.

[123] A banking entity approaching a compliance threshold is encouraged to contact its primary financial regulatory agency to discuss the steps the banking entity should take to satisfy its compliance obligations under the new threshold.

[124] *See* BPI.

[125] *See* final rule § ■■.20(i).

[126] 12 U.S.C. 1851(h)(6).

[127] *See* 2013 rule § ■■.3(b)(1)(i).

[128] *See* 2013 rule § ■■.3(b)(2).

[129] *See* 2013 rule § ■■.3(b)(1)(ii).

connection with the activities of such business.[130]

The proposal would have replaced the 2013 rule's short-term intent prong with a new third prong based on the accounting treatment of a position (the accounting prong). The proposal also would have added a presumption of compliance with the proposed rule's prohibition on proprietary trading for trading desks whose activities are not covered by the market risk capital prong or the dealer prong if the activities did not exceed a specified quantitative threshold. The proposal would have retained a modified version of the market risk capital prong and would have retained the dealer prong unchanged from the 2013 rule. As described in detail below, the final rule retains the three-pronged definition of trading account from the 2013 rule and does not adopt the proposed accounting prong or presumption of compliance with the proprietary trading prohibition. Rather, the final rule makes targeted changes to the definition of trading account.

Among other changes, the final rule eliminates the 2013 rule's rebuttable presumption and replaces it with a rebuttable presumption that financial instruments held for sixty days or more are not included in the trading account under the short-term intent prong.[131] The agencies believe that the market risk capital prong, which expressly includes certain short-term trading activities, is an appropriate interpretation of the statutory definition of trading account for all firms subject to the market risk capital rule.[132] Therefore, the final rule provides that banking entities that are subject to the market risk capital prong are not subject to the short-term intent prong.[133] However, the final rule provides that banking entities that are subject to the short-term intent prong may elect to apply the market risk capital prong instead of the short-term intent prong.[134] These changes are designed to simplify and tailor the trading account definition in a manner that is consistent with section 13 of the BHC Act and applicable safety and soundness standards.

i. Accounting Prong

The proposed accounting prong would have provided that ''trading account'' meant any account used by a banking entity to purchase or sell one or more financial instruments that is recorded at fair value on a recurring basis under applicable accounting standards.[135] Such instruments generally include, but are not limited to, derivatives, trading securities, and available-for-sale securities. The proposed inclusion of this prong in the definition of ''trading account'' was intended to provide greater certainty and clarity to banking entities than the short-term intent prong in the 2013 rule about which transactions would be included in the trading account, because banking entities could more readily determine which positions are recorded at fair value on their balance sheets.[136]

Many commenters strongly opposed replacing the short-term intent prong with the accounting prong.[137] These commenters asserted that the accounting prong could inappropriately scope in, among other things: Over $400 billion in available-for-sale debt securities; [138] certain long term investments; [139] static hedging of long term investments; [140] traditional asset-liability management activities; [141] derivative transactions entered into for any purpose and duration; [142] long-term holdings of commercial mortgage-backed securities; [143] seed capital investments; [144] investments that are expressly permitted under the covered fund provisions; [145] investments in connection with employee compensation; [146] bank holding company-permissible investments in enterprises engaging in activities that are part of the business of banking or incidental thereto, as well as other investments made pursuant to the BHC Act; [147] and financial holding company merchant banking investments.[148] Some commenters argued that the accounting prong was inconsistent with the statute; [149] would lead to increased regulatory burden and uncertainty; [150] could encourage banking entities not to elect to account for financial instruments at fair value, thereby reducing transparency into banking entities' financial reporting and frustrating risk management practices that are based on the fair value option; [151] could result in disparate treatment of the same activity between two banking entities where one banking entity elects the fair value option and the other does not; [152] would have a disproportionately negative impact on midsize and regional banks; [153] could negatively impact the securitization industry if liquidity for asset-backed securities is impeded; [154] could inappropriately scope in investment advisers' use of seed capital to develop products, services, or strategies for asset management clients; [155] could lead to increased burden for international banks by requiring them to apply both local accounting standards and U.S. generally accepted accounting principles (GAAP) to non-U.S. positions, one for regular accounting purposes and one specifically for assessing compliance with the regulations implementing section 13 of the BHC Act; [156] that the exclusions and exemptions from the prohibition on proprietary trading in the 2013 rule are ill-suited with respect to positions captured by the accounting prong; [157] and that fair valuation of

[130] *See* 2013 rule § __.3(b)(1)(iii). An insured depository institution may be registered as a swap dealer, but only the swap dealing activities that require it to be so registered are covered by the dealer trading account. If an insured depository institution purchases or sells a financial instrument in connection with activities of the insured depository institution that do not trigger registration as a swap dealer, such as lending, deposit-taking, the hedging of business risks, or other end-user activity, the financial instrument is included in the trading account only if the instrument falls within the definition of trading account under at least one of the other prongs. *See* 79 FR at 5549.

[131] *See* final rule § __.3(b)(4).

[132] *See* 12 U.S.C. 1851(h)(6); *see also* Instructions for Preparation of Consolidated Financial Statements for Holding Companies, Trading Assets and Liabilities, Schedule HC–D, *available at https://www.federalreserve.gov/reportforms/forms/FR_Y-9C20190731_i.pdf,* and Instructions for Preparation of Consolidated Reports of Condition and Income, Schedule RC–D, *available at https://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201803_i.pdf.*

[133] *See* final rule § __.3(b)(2)(i).

[134] *See* final rule § __.3(b)(2)(ii).

[135] *See* proposed rule § __.3(b)(3); 83 FR at 33447–48.

[136] *See* 83 FR at 33447–48.

[137] *See, e.g.,* BOK; New York Community Bank (NYCB); IAA; ABA; KeyCorp; International Swaps and Derivatives Association (ISDA); Mortgage Bankers Association (MBA); Commercial Real Estate Finance Council (CREFC), Mortgage Bankers Association, and the Real Estate Roundtable (Real Estate Associations); State Street; Chatham Financial et al. (Chatham); Capital One et al.; BPI; FSF; Goldman Sachs; SIFMA; Center for Capital Markets Competitiveness (CCMC); IIB; Credit Suisse; EBF; and Arvest.

[138] *See, e.g.,* BPI and SIFMA.

[139] *See, e.g.,* Capital One et al.; BPI; SIFMA; and CCMR.

[140] *See, e.g.,* BPI and ISDA.

[141] *See, e.g.,* KeyCorp; BPI; Capital One et al.; FSF; and Goldman Sachs.

[142] *See e.g.,* ISDA and BPI.

[143] *See* MBA.

[144] *See, e.g.,* ICI; Capital One et al.; Credit Suisse; FSF; and SIFMA.

[145] *See, e.g.,* Capital One et al. and BPI.

[146] *See, e.g.,* Capital One et al. and BPI.

[147] *See* Capital One et al.

[148] *See* Capital One et al.

[149] *See, e.g.,* Capital One et al.; CCMC; IAA; ABA; ISDA; Credit Suisse; CREFC; BPI; FSF; Goldman Sachs; and SIFMA.

[150] *See, e.g.,* CCMC; JBA; Structured Finance Industry Group (SFIG); IIB; American Action Forum; ABA; BPI; ISDA; and SIFMA.

[151] *See, e.g.,* BPI and IIB.

[152] *See* BPI.

[153] *See, e.g.,* BOK; ABA; and NYCB.

[154] *See* SFIG.

[155] *See* IAA.

[156] *See* IIB.

[157] *See, e.g.,* SIFMA; BPI; CCMR; FSF; and BB&T.

assets and liabilities under applicable accounting standards is not indicative of short-term trading intent.[158]

Some commenters expressed a preference for the 2013 rule's short-term intent prong over the accounting prong.[159] Other commenters suggested revisions to the accounting prong if adopted, such as excluding from the definition of trading account any financial instrument for which financial institutions record the change in value in other comprehensive income; [160] expressly excluding available-for-sale portfolios from the accounting prong; [161] and clarifying that non-U.S. banking entities are permitted to use accounting standards adopted by individual banking entities other than International Financial Reporting Standards and GAAP.[162] One commenter expressed concern that a banking entity could circumvent the prohibition on proprietary trading by recording financial instruments at amortized cost instead of fair value.[163]

Some commenters supported adopting the accounting prong.[164] One commenter urged the agencies to retain the short-term intent prong and to adopt the accounting prong as an additional test without any presumption of compliance.[165] Another commenter argued that the accounting prong should be implemented as a new presumption within the short-term trading prong.[166] This commenter urged the agencies to revise the accounting prong by codifying language from the applicable accounting standards and coupling this with preamble language indicating that the agencies intend to interpret the accounting prong in a manner that is consistent with GAAP and international accounting codifications and guidance, thereby allowing the agencies to definitively interpret the text rather than accounting authorities, who might not consider the regulations implementing section 13 of the BHC Act when making further changes to accounting standards.[167]

After considering all comments received,[168] the agencies are not adopting the accounting prong in the final rule. The agencies agree with commenters' concerns that the accounting prong would have inappropriately scoped in many financial instruments and activities that section 13 of the BHC Act was not intended to capture, including some long-term investments. In addition, the accounting prong would have inappropriately scoped in entire categories of financial instruments, regardless of the banking entity's purpose for buying or selling the instrument, such as all derivatives and equity securities with a readily determinable fair value. Furthermore, the accounting prong would have captured certain seeding activity that would otherwise be permitted under subpart C of the regulations implementing section 13 of the BHC Act. As noted in the preamble to the proposed rule, the impetus behind replacing the short-term intent prong with the accounting prong was to address the uncertain application of the short-term intent prong to certain trades.[169] As discussed in detail below, the agencies have modified the short-term intent prong to provide more clarity. The agencies have also provided further clarity to the trading account definition in the final rule by adding additional exclusions from the "proprietary trading" definition. The agencies are adopting these clarifying measures as a more tailored approach to address the difficulties that have arisen under the existing short-term intent prong.

ii. Presumption of Compliance With the Prohibition on Proprietary Trading

Under the accounting prong, the proposal would have added a presumption of compliance with the proprietary trading prohibition based on an objective, quantitative measure of a trading desk's activities.[170] Under this proposed presumption of compliance, the activities of a trading desk of a banking entity that are not covered by the market risk capital prong or the dealer prong— *i.e.,* the activities that would be within the trading account under the proposed accounting prong— would have been presumed to comply with the proposed rule's prohibition on proprietary trading if the activities did not exceed a specified quantitative threshold. The trading desk would have remained subject to the prohibition on proprietary trading and, unless the desk engaged in a material level of trading activity (or the presumption of compliance was rebutted), the desk would not have been required to comply with the more extensive requirements that would otherwise apply under the proposal to demonstrate compliance. The agencies proposed to use the absolute value of the trading desk's profit and loss on a 90-calendar-day rolling basis as the relevant quantitative measure for this threshold.

Two commenters supported adopting the presumption of compliance with the prohibition on proprietary trading.[171] Several commenters opposed adopting this presumption of compliance.[172] Some of these commenters argued that the presumption of compliance could allow banks to evade the restrictions on proprietary trading by splitting trades over multiple trading desks.[173] One of these commenters suggested that the presumption of compliance for trading desk activities that would have been within the trading account under the accounting prong in the proposed rule could invite proprietary trading within the $25 million threshold.[174] Another commenter had several concerns with this proposal, including that not all businesses calculate daily profits and losses, and that even businesses that do not sell a single position within a 90-day period might exceed $25 million in unrealized gains and losses.[175] Two commenters asserted there is no statutory basis to permit a *de minimis* amount of proprietary trading.[176] Other commenters asserted that the presumption could increase regulatory burden.[177] Several commenters argued that, if the presumption is adopted, the threshold should be increased,[178] or the method of calculating profit and loss should be modified.[179] Many commenters stated that the proposed trading desk-level presumption of compliance did not adequately address the overbreadth of the accounting prong.[180]

After considering the comments, the agencies have decided not to adopt a trading desk-level presumption of compliance with the prohibition on

[158] *See, e.g.,* Capital One et al.; ABA; BPI; FSF; SIFMA; and Credit Suisse.

[159] *See, e.g.,* Chatham; BPI; SIFMA; IIB; Credit Suisse; and Arvest.

[160] *See* BOK.

[161] *See* BOK.

[162] *See* JBA.

[163] *See* Volcker Alliance.

[164] *See, e.g.,* Public Citizen; CAP; Better Markets; and AFR.

[165] *See* CAP.

[166] *See* Better Markets.

[167] *See* Better Markets.

[168] *See, e.g.,* BOK; NYCB; IAA; ABA; KeyCorp; ISDA; MBA; Real Estate Associations; State Street; Chatham; Capital One et al.; BPI; FSF; Goldman Sachs; SIFMA; CCMC; IIB; Credit Suisse; EBF; CREFC; and Arvest.

[169] *See* 83 FR at 33448.

[170] *See* proposed rule § ■■.3(c); 83 FR at 33449–51.

[171] *See, e.g.,* New England Council and CFA.

[172] *See, e.g.,* Volcker Alliance; Public Citizen; CAP; Bean; Feng; AFR; and Better Markets.

[173] *See, e.g.,* Volcker Alliance; Public Citizen; CAP; and Bean.

[174] *See* Public Citizen.

[175] *See* IIB.

[176] *See, e.g.,* Bean and CAP.

[177] *See, e.g.,* BOK; BPI; IIB; and JBA.

[178] *See, e.g.,* BOK; BPI; IIB; and Capital One et al.

[179] *See, e.g.,* CFA.

[180] *See, e.g.,* Capital One et al.; BPI; FSF; and SIFMA.

proprietary trading. As discussed in the preamble to the proposal, this presumption of compliance would have been available only for a trading desk's activities that would have been within the trading account under the proposed accounting prong, and not for a trading desk that is subject to the market risk capital prong or the dealer prong of the trading account definition. This presumption of compliance was intended to address the potential impact of the accounting prong, which the proposal recognized would have been a significant change from the 2013 rule. In particular, the proposal noted that the proposed trading desk-level presumption of compliance with the prohibition on proprietary trading was intended to allow banking entities to conduct ordinary banking activities without having to assess every individual trade for compliance with subpart B of the implementing regulations and the proposed accounting prong.[181] Since the agencies are not adopting the accounting prong and are adopting additional clarifying revisions to the short-term intent prong, the agencies have determined it is not necessary to adopt the presumption of compliance.

iii. Short-Term Intent Prong

The 2013 rule's short-term intent prong included within the definition of trading account the purchase or sale of one or more financial instruments principally for the purpose of (A) short-term resale, (B) benefitting from actual or expected short-term price movements, (C) realizing short-term arbitrage profits, or (D) hedging one or more positions resulting from the purchases or sales of financial instruments for the foregoing purposes.[182] Under the 2013 rule's rebuttable presumption, the purchase (or sale) of a financial instrument by a banking entity was presumed to be for the trading account under the short-term intent prong if the banking entity held the financial instrument for fewer than sixty days or substantially transferred the risk of the financial instrument within sixty days of the purchase (or sale). A banking entity could rebut the presumption by demonstrating, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in the short-term intent prong.[183]

Several commenters stated that, for banking entities that are subject to the market risk capital prong, the short-term intent prong is redundant.[184] In addition, several commenters stated that the final rule should eliminate the short-term intent prong altogether, as proposed.[185] Other commenters stated that, consistent with the statutory definition of trading account, the agencies should not eliminate the short-term intent prong.[186] One commenter suggested re-adopting the short-term intent prong but defining the term ''short-term'' differently based on asset class.[187] Several commenters supported retaining the short-term intent prong with modifications, such as eliminating or reversing the rebuttable presumption or aligning the short-term intent prong more closely with the market risk capital prong.[188] The agencies agree that there is substantial overlap between the short-term intent prong and the market risk capital prong and have revised the definition of trading account accordingly.

Under the final rule, the definition of trading account includes any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from the purchases or sales of financial instruments for the foregoing purposes.[189] The agencies believe that it is necessary to include a prong other than the market risk capital prong or the dealer prong to define ''trading account'' for banking entities that are subject to the final rule but are not subject to the market risk capital prong. The agencies believe that requiring banking entities that are not subject to the market risk capital rule to apply the market risk capital prong in order to identify the scope of positions subject to the Volcker Rule's proprietary trading provisions could be unduly complex and burdensome for banking entities with smaller and less active trading activities. The final rule allows a banking entity not subject to the market risk capital prong to define its trading account by reference to either the short-term intent prong or the market risk capital prong because both tests are consistent with the statutory definition of trading account; this flexible approach for banking entities with less trading activities is appropriate for various reasons, including because these banking entities are already familiar with the short-term intent prong.[190]

Under the final rule, the regulatory short-term intent prong applies only to a banking entity that is not subject to the market risk capital prong and that has not elected to apply the market risk capital prong to determine the scope of the banking entity's trading account.[191] For purposes of the final rule, a banking entity is subject to the market risk capital prong 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.[192] Applying the short-term intent prong only to banking entities whose trading account is not covered by the market risk capital prong will simplify application of the rule. No longer applying the short-term intent prong to banking entities that are subject to the market risk capital prong is appropriate because the scope of activities captured by the short-term intent prong is substantially similar to the scope of activities captured by the market risk capital prong. Indeed, the preamble to the 2013 rule noted that the definition of trading position in the market risk capital rule largely parallels the statutory definition of trading account,[193] which in turn mirrors the language in the short-term intent prong. Accordingly, the agencies believe that a banking entity should be subject either to the short-term intent prong or to the market risk capital prong, but not both.[194]

The final rule allows a banking entity that is not subject to the market risk capital prong to elect to apply the market risk capital prong in place of the short-term intent prong.[195] The final rule includes this option to provide parity between smaller banking entities that are not subject to the market risk capital rule and larger banking entities with active trading businesses that are

[181] *See* 83 FR at 33449.

[182] *See* 2013 rule § ▮▮.3(b)(1)(i).

[183] *See* 2013 rule § ▮▮.3(b(2).

[184] *See, e.g.,* Capital One et al.; BPI; FSF; KeyCorp; and SIFMA.

[185] *See, e.g.,* JBA; Credit Suisse; CREFC; and SIFMA.

[186] *See* AFR and Bean.

[187] *See* Occupy the SEC.

[188] *See, e.g.,* SIFMA; BPI; State Street; Chatham; FSF; CCMR; ABA; KeyCorp; Capital One et al.; Arvest; and IIB.

[189] *See* final rule § ▮▮.3(b)(1)(i).

[190] *See* 12 U.S.C. 1851(h)(6).

[191] *See* final rule § ▮▮.3(b)(2)(i), (ii).

[192] *See* 12 CFR part 3, subpart F; part 217, subpart F; part 324, subpart F.

[193] *See* 79 FR at 5548.

[194] A number of commenters suggested that, due to the overlap between the market risk capital prong and the short-term intent prong, banking entities that are subject to the market risk capital prong should not also be subject to the short-term intent prong. *See, e.g.,* Capital One et al.; BPI; FSF; Goldman Sachs; CREFC; and SIFMA.

[195] *See* final rule § ▮▮.3(b)(2)(ii).

subject to the market risk capital prong.[196] Under the final rule, a banking entity that is not subject to the market risk capital rule may choose to define its trading account as if the banking entity were subject to the market risk capital prong. If a banking entity opts into the market risk capital prong, the banking entity's trading account would include all accounts used by the banking entity to purchase or sell one or more financial instruments that would be covered positions and trading positions under the market risk capital rule if the banking entity were subject to the market risk capital rule. Banking entities that do not make this election will continue to apply the short-term intent prong.

Under the final rule, an election to apply the market risk capital prong must be consistent among a banking entity and all of its wholly owned subsidiaries.[197] This consistency requirement is intended to facilitate banking entities' compliance with the proprietary trading prohibition by subjecting wholly owned legal entities within a firm to the same definition. Requiring a consistent definition of ''trading account'' is particularly important to simplify compliance because a trading desk may book trades into different legal entities within an organization, and having a consistent definition of ''trading account'' among these entities should help ensure that each banking entity can identify relevant trading activity and meet its compliance obligations under the final rule. This requirement is also expected to facilitate the agencies' supervision of compliance with the final rule. This consistency requirement would apply only to a banking entity and its wholly owned subsidiaries. In the case of minority-owned subsidiaries or other subsidiaries that the banking entity does not functionally control, it may be impractical for one banking entity within the organization to ensure that all affiliates will make a consistent election. However, the relevant primary financial regulatory agency may subject a banking entity that is not a wholly owned subsidiary to the consistency requirement if the agency determines it is necessary to prevent evasion of the rule's requirements. When exercising this authority, the relevant primary financial regulatory agency will follow the same notice and response procedures used elsewhere in the final rule.

iv. 60-Day Rebuttable Presumption

The proposal would have eliminated the 2013 rule's 60-day rebuttable presumption. Many commenters supported the proposed rule's elimination of this rebuttable presumption.[198] Some commenters urged the agencies to establish a presumption that positions held for more than 60 days are not proprietary trading.[199] Some commenters suggested that the agencies should presume, for banking entities not subject to the market risk capital rule, that financial instruments held for longer than 60 days, or that have an original maturity or remaining maturity upon acquisition of fewer than 60 days to their stated maturities, are not for the banking entity's trading account.[200] One commenter suggested that any third prong to the definition of trading account that applies to banking entities that are not subject to the market risk capital rule should have a rebuttable presumption that any position held by the banking entity as principal for 60 days or more is not for the trading account, as well as a reasonable challenge procedure through which a banking entity would be provided an opportunity to demonstrate to its primary financial regulatory agency that positions held for fewer than 60 days do not constitute proprietary trading.[201] Several commenters asked that the agencies—if they do not eliminate the presumption—provide guidance on the rebuttal process,[202] or make certain revisions to the presumption, such as revising the ''substantial transfer of risk'' language; [203] exempting financial instruments close to maturity; [204] and excluding hedging activity.[205] Some commenters argued, in contrast, that the 60-day rebuttable period was under-inclusive.[206] One commenter argued that any position purchased or sold within 180 days should be automatically included within the definition of trading account, or, in the alternative, that the presumption should be extended from 60 to 180 days, and the agencies should mandate ongoing monitoring and disclosure of all components, excluded or not, of the banking entities' reported trading account assets.[207] This commenter also argued that there should not be a presumption that certain positions are not within the trading account; that documentation requirements for rebutting the presumption should be clearly specified and the criteria more restrictive; that all arbitrage positions should be presumed to be trading positions; and that the definition of ''short-term'' should vary by asset class. Another commenter generally opposed eliminating the 60-day rebuttable presumption.[208]

After considering all comments received, the agencies are eliminating the 60-day rebuttable presumption from the 2013 rule and establishing a new rebuttable presumption that financial instruments held for sixty days or more are not within the short-term intent prong. Since the 2013 rule came into effect, the agencies have found that the rebuttable presumption has captured many activities that should not be included in the definition of proprietary trading,[209] which, under the statute, only covers buying and selling financial instruments principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements).[210] Several commenters supported eliminating the 2013 rule's rebuttable presumption for this reason or due to difficulties in rebutting the presumption.[211] Given the type of activities that have triggered the 2013 rule's rebuttable presumption but that are not undertaken principally for the purpose of selling in the near-term,[212]

[196] Several commenters recommended defining the trading account solely by reference to the dealer prong and market risk capital prong for banking entities subject to the market risk capital rule. *See, e.g.,* Capital One et al.; BPI; FSF; Goldman Sachs; CREFC; and SIFMA. One commenter suggested that banking entities that are not subject to the market risk capital rule and subject to a third prong should be allowed to elect to be treated as a banking entity subject to the market risk capital rule for purposes of the regulations implementing section 13 of the BHC Act. This approach would maintain parity between banking entities that are subject to the market risk capital rule and those that are not. *See* SIFMA.

[197] *See* final rule § ▮▮.3(b)(3).

[198] *See, e.g.,* State Street; Chatham; BPI; FSF; CCMR; and CFA.

[199] *See, e.g.,* ABA; KeyCorp; Capital One et al.; State Street; and Arvest.

[200] *See, e.g.,* ABA; Arvest; BPI; SIFMA; and IIB.

[201] *See* SIFMA.

[202] *See, e.g.,* ABA; Arvest; BPI; SIFMA; State Street; and FSF.

[203] *See, e.g.,* ABA and Arvest.

[204] *Id.*

[205] *See* Capital One et al.

[206] See AFR and Occupy the SEC.

[207] *See* Occupy the SEC.

[208] *See* Bean.

[209] For example, asset-liability, liquidity management activities, transactions to correct error trades and loan-related swaps. *See* Part IV.B.2.b.i–iii.

[210] 12 U.S.C. 1851(h)(4) and (6).

[211] *See, e.g.,* State Street; Chatham; BPI; FSF; CCMR; and CFA.

[212] Such activities include a foreign branch of a U.S. banking entity purchasing a foreign sovereign debt obligation with remaining maturity of fewer than 60 days in order to meet foreign regulatory requirements. Similarly, error correcting trades and matched derivative transactions, discussed *infra* may have triggered the 2013 rule's rebuttable presumption but are not undertaken principally for the purpose of selling in the near term (or otherwise

Continued

the agencies have concluded that it is not appropriate to continue to presume short-term trading intent from holding a financial instrument for fewer than 60 days.

However, the agencies recognize the utility for both the agencies and the subject banking entities of an objective time-based standard.[213] The final rule contains a new rebuttable presumption: The purchase or sale of a financial instrument presumptively lacks short-term trading intent if the banking entity holds the financial instrument for 60 days or longer and does not transfer substantially all of the risk of the financial instrument within 60 days of the purchase (or sale).[214] The agencies agree with commenters that a banking entity subject to the short-term intent prong that holds an instrument for at least 60 days should receive the benefit of a presumption that the trade was not entered into for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements. Replacing the 2013 rule's rebuttable presumption with a rebuttable presumption that financial instruments held for sixty days or longer are not within the short-term intent prong will provide clarity for banking entities with respect to such positions, without imposing the burden associated with the 2013 rule's rebuttable presumption.

In light of the revision to the 60-day rebuttable presumption, the agencies do not believe it is necessary to provide a formal challenge procedure with respect to financial instruments that are purchased or sold within 60 days. Under the final rule, such activity is no longer presumptively within a banking entity's trading account.

As in the 2013 rule, the final rule's presumption only applies to the short-term intent prong and does not apply to the market risk capital or dealer prongs

v. Market Risk Capital Prong Modification

The proposal would have revised the market risk capital prong to apply to the activities of foreign banking organizations (FBOs) to take into account the different market risk frameworks FBOs may have in their home countries.[215] Specifically, the proposal included within the market risk capital prong an alternative definition that permitted a banking entity that is not, and is not controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or any State, to include any account used by the banking entity to purchase or sell one or more financial instruments that are subject to risk-based capital requirements under a market risk framework established by the home-country supervisor that is consistent with the market risk framework published by the Basel Committee on Banking Supervision (Basel Committee), as amended from time to time.

One commenter asserted that, under some foreign regulatory market risk capital frameworks, this expansion would capture positions that are not held for short-term trading.[216] This commenter advocated adopting a flexible approach where foreign banking entities could exclude a position subject to a foreign jurisdiction's market risk capital framework from the trading account by demonstrating that the position was not acquired for short-term purposes or otherwise should not be treated as a trading account position.[217]

After considering the comments on this issue,[218] the agencies have decided not to modify the market risk capital prong to incorporate foreign market risk capital frameworks. The agencies believe that relying on the short-term intent prong, market risk capital prong, and dealer prong will ensure consistent treatment of U.S. and foreign banking entities. Foreign banking entities that are not subject to the market risk capital rule may continue to use the short-term intent prong to define their trading accounts. However, a banking entity, including a foreign banking entity, may elect to apply the market risk capital prong in determining the scope of its trading account. As discussed above, a banking entity that uses the market risk capital prong to determine the scope of its trading account is not also subject to the short-term intent prong. This approach will provide appropriate parity between U.S. and foreign banking entities and will also maintain consistency with the statutory trading account definition.[219]

Accordingly, the final rule retains a market risk capital prong that is substantially similar to that in the 2013 rule. The final rule's market risk capital prong includes within the definition of trading account any account that is used by a banking entity to purchase or sell one or more financial instruments that are both covered positions and trading positions under the market risk capital rule (or hedges of other covered positions under the market risk capital rule), if the banking entity, or any affiliate that is consolidated with the banking entity for regulatory reporting purposes, calculates risk-based capital ratios under the market risk capital rule.[220]

In addition, the final rule includes a transition period for banking entities as they become subject to the market risk capital prong.[221] Under the final rule, if a banking entity is subject to the short-term intent prong and then becomes subject to the market risk capital prong, the banking entity may continue to apply the short-term intent prong instead of the market risk capital prong for one year from the date on which it becomes, or becomes consolidated for regulatory reporting purposes with, a banking entity that calculates risk-based capital ratios under the market risk capital rule. The agencies are adopting this transition period to provide banking entities a reasonable period to update compliance programs.

The market risk capital rule includes a position that is reported as a covered position for regulatory reporting purposes on applicable reporting forms.[222] Certain banking entities that may be subject to, or elect to apply, the

with the intent to resell in order to profit from short-term price movements).

[213] *See* 79 FR at 5550; *see also* ABA; KeyCorp; Capital One et al.; State Street; Arvest; and SIFMA.

[214] *See* final rule § ■ ■.3(b)(4).

[215] *See* proposed rule § ■ ■. 3(b)(1)(ii); 83 FR at 33447.

[216] *See* IIB.

[217] *See id.*

[218] *See* IIB (noting that the scope of some foreign supervisory market risk capital frameworks may capture positions that are not held solely for short-term purposes and thus should be out of scope for purposes of the final rule).

[219] In the course of developing the final rule, the agencies have considered the prudential actions of foreign regulators in this area and the resulting effects on U.S. and non-U.S. financial institutions and the relevant markets in which they participate.

[220] *See* final rule § ■ ■.3(b)(1)(ii). The final rule's market risk capital prong has, however, been modified as compared to the 2013 rule to account for a banking entity that is not consolidated with an affiliate (for regulatory reporting purposes) that calculates risk-based capital ratios under the market risk capital rule. For example, the trading positions of a broker-dealer that is not consolidated with its parent bank holding company will not be included in the holding company's trading positions in the holding company's Form FR Y–9C. In such an instance, even though the broker-dealer is affiliated with an entity that calculates risk-based capital ratios under the market risk capital rule, it would not be subject to the market capital risk prong due to the fact that the broker-dealer is not consolidated with the affiliate for regulatory reporting purposes. As a result, the broker-dealer would be subject to the amended short-term intent prong and the dealer prong (with respect to instruments purchased or sold in connection with the activities that require the broker-dealer to be licensed or registered as such). It may, however, be able to elect to use the market risk capital prong (as an alternative to the short-term intent prong) by following the procedures described above.

[221] Unlike the Volcker Rule compliance program requirements, which are based on average gross trading assets and liabilities over the prior four quarters, the thresholds in the market risk capital rule are based on the most recent quarter.

[222] *See* 12 CFR 3.202; 12 CFR 217.202; 12 CFR 324.202 (defining ''covered position'').

market risk capital prong may not report positions on applicable regulatory reporting forms as trading assets or trading liabilities. Therefore, the final rule amends the definition of ''market risk capital rule covered position and trading position'' to clarify that this definition includes any position that meets the criteria to be a covered position and a trading position, without regard to whether the financial instrument is reported as a covered position or trading position on any applicable regulatory reporting forms. The final rule also modifies the definition of ''market risk capital rule'' to update a cross-reference to the Board's capital rules and to clarify what the applicable market risk capital rule would be for a firm electing to apply the market risk capital prong.[223]

vi. Dealer Prong

The proposal did not propose revisions to the dealer prong. However, several commenters requested that the agencies clarify that not all purchases and sales of financial instruments by a dealer are captured by the dealer prong.[224] Specifically, these commenters requested that the agencies clarify that the dealer prong does not capture purchases or sales made by a dealer in a non-dealing capacity, including financial instruments purchased for long-term investment purposes.[225] Among other things, those commenters noted that without such modifications, the dealer prong may require a position-by-position analysis to confirm whether a long-term investment is part of the trading account. Another commenter requested that the agencies revise the dealer prong to ensure that derivatives activities remain in the trading account without regard to potential SEC and CFTC actions on the *de minimis* thresholds or other registration requirements, and that such derivatives activities do not benefit from any presumption of compliance.[226] The final rule retains the 2013 rule's dealer prong without any substantive change.[227]

The final rule's dealer prong includes within the definition of trading account any account that the banking entity uses to purchase or sell one or more financial instruments for any purpose if the banking entity (A) is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or (B) is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.[228] In response to commenters and consistent with the 2013 rule, the agencies reaffirm that a banking entity may be licensed or registered as a dealer, but only the types of activities that require it to be so licensed or registered are covered by the dealer prong. Thus, if a banking entity purchases or sells a financial instrument in connection with activities that are not the types of activities that would trigger registration as a dealer, the purchase or sale of the financial instrument is not covered by the dealer prong. However, it may be included in the trading account under the short-term intent prong or the market risk capital prong, as applicable.[229] Moreover, in response to commenters' concerns that the existing rule may require dealers to conduct a position-by-position analysis of their trading activities to determine whether a position is captured by the dealer prong, the agencies believe that the changes being adopted today, particularly the exclusions for financial instruments that are not trading assets or liabilities,[230] should help alleviate those concerns by narrowing the range of transactions covered by the rule.

b. Proprietary Trading Exclusions

Section ■ ■.3 of the 2013 rule generally prohibits a banking entity from engaging in proprietary trading. In addition to defining the scope of trading activity subject to the prohibition on proprietary trading, the 2013 rule also provides several exclusions from the definition of proprietary trading. Based on experience implementing the 2013 rule, the agencies proposed modifying the exclusion for liquidity management and adopting new exclusions for transactions made to correct errors and for certain offsetting swap transactions. In addition, the agencies requested comment regarding whether any additional exclusions should be added, for example, to address certain derivatives entered into in connection with a customer lending transaction. The agencies are adopting the liquidity management exclusion as proposed, with a modification to encompass non-deliverable cross-currency swaps, and additional exclusions for the following activities: (i) Trading activity to correct trades made in error, (ii) loan-related and other customer accommodation swaps, (iii) matched derivative transactions, (iv) hedges of mortgage servicing rights where trading in the underlying mortgage servicing rights is not prohibited by the rule; and (v) financial instruments that do not meet the definition of trading assets or trading liabilities under applicable reporting forms.

i. Liquidity Management Exclusion Amendments

The 2013 rule excludes 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.[231] This exclusion contains several requirements. First, the liquidity management exclusion is limited by its terms to securities and requires that transactions be conducted pursuant to a liquidity management plan that specifically contemplates and authorizes the particular securities to be used for liquidity management purposes; describes the amounts, types, and risks of securities that are consistent with the banking entity's liquidity management plan; and the liquidity circumstances in which the particular securities may or must be used. Second, any purchase or sale of securities contemplated and authorized by the plan must be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes. Third, the plan must require that any securities purchased or sold for liquidity management purposes be highly liquid and limited to instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements. Fourth, the plan must limit any

[223] *See* 12 CFR part 217.

[224] *See, e.g.,* BPI; FSF; and SIFMA.

[225] *See e.g.,* BPI; FSF; and SIFMA.

[226] *See* Better Markets.

[227] In response to the commenter, the agencies clarify that banking entities that are licensed or registered (or required to be licensed or registered) as dealers, swap dealers, or security-based swap dealers analyze the types of activities that would be captured by the dealer prong without regard to the *de minimis* thresholds for swap dealer or security-based swap dealer registration. However, regardless of whether a banking entity is so licensed or registered, the banking entity is also required to determine whether a purchase or sale of a financial instrument would be captured by either the short-term intent prong or the market risk capital prong, as applicable.

[228] *See* final rule § ■ ■.3(b)(1)(iii).

[229] *See* final rule § ■ ■.3(b)(1)(i), (ii).

[230] *See infra* section IV.B.1.b.v.

[231] *See* 2013 rule § ■ ■.3(d)(3).

securities purchased or sold for liquidity management purposes to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan. Fifth, the banking entity must incorporate into its compliance program internal controls, analysis, and independent testing designed to ensure that activities undertaken for liquidity management purposes are conducted in accordance with the requirements of the 2013 rule and the banking entity's liquidity management plan. Finally, the plan must be consistent with the supervisory requirements, guidance, and expectations regarding liquidity management of the agency responsible for regulating the banking entity. The 2013 rule established these requirements to provide some safeguards to ensure that the liquidity management exclusion is not misused for the purpose of impermissible proprietary trading.[232] While some safeguards around a banking entity's liquidity management are appropriate, the restrictions under the 2013 rule have limited the ability of banking entities to engage in certain types of bona fide liquidity management activities.

The proposal would have amended the exclusion for liquidity management activities to allow banking entities to use foreign exchange forwards and foreign exchange swaps, each as defined in the Commodity Exchange Act,[233] and physically settled cross-currency swaps (*i.e.,* cross-currency swaps that involve an actual exchange of the underlying currencies) as part of their liquidity management activities.[234] Foreign exchange forwards, foreign exchange swaps, and physically settled cross-currency swaps are often used by trading desks of foreign branches and subsidiaries of a U.S. banking entity to manage liquidity inforeign jurisdictions.[235] The proposal would have provided that a banking entity could use foreign exchange forwards, foreign exchange swaps, and physically settled cross-currency swaps for liquidity management purposes provided that the use of such financial instruments was in accordance with a documented liquidity management plan.[236]

Many commenters supported the proposed expansion of activities covered by the liquidity management exclusion.[237] However, some commenters expressed the view that the expansion did not go far enough and should be expanded to include other types of financial instruments.[238] One commenter asserted that expanding the scope of the liquidity management exclusion would streamline compliance for banking entities without introducing additional safety and soundness concerns or the risk of impermissible proprietary trading.[239] Some commenters said that non-deliverable currency derivatives should also qualify for the exclusion, because there are some currencies for which physically settled cross-currency swaps are not available.[240] Additionally, other commenters argued that given the role of derivatives in liquidity risk management, the agencies should expand the exclusion further to cover all derivatives, including interest rate swaps.[241] Certain commenters suggested that the agencies should further expand the liquidity management exclusion to include all financial instruments that would be convenient and useful for managing liquidity and asset-liability mismatch risks of the organization.[242]

Several commenters claimed that the eligibility criteria of the liquidity management exclusion are opaque and confusing, and suggested modifying, clarifying, or eliminating some or all of the requirements.[243] For example, several commenters argued that the requirement to maintain a documented liquidity management plan with certain enumerated elements is unnecessarily prescriptive.[244] Some commenters stated that banking entities do not rely on the exclusion due to the number and limiting nature of the requirements.[245] Some commenters argued that the agencies should be promoting, rather than restricting, appropriate liquidity management and structural interest rate risk management activities, and that the retention of these requirements is not consistent with the removal of the prescriptive requirements of Appendix B in the 2013 rule.[246] Other commenters argued that the agencies should eliminate the compliance-related requirements and permit banking entities to design and manage their liquidity management function according to their existing internal compliance frameworks.[247] In addition, a commenter recommended clarifying whether treasury functions within banking entities may manage global liquidity through the newly added financial instruments.[248]

In contrast, other commenters did not support the proposed expansion of the liquidity management exclusion.[249] One commenter asserted that the proposed rule fails to demonstrate the need for providing banks greater opportunity to use foreign currency transactions to manage their liquidity needs when those needs are already being met via the securities markets.[250] Another commenter argued that the proposed change would create concern for the currency markets by making it easier for trading desks to trade these instruments for speculative purposes under the guise of legitimate liquidity management.[251] One commenter argued that the proposal would encourage banking entities to exclude impermissible trades as liquidity management and engage in speculative currency trading. As a result, it would increase banks' risk-taking and moral hazard, reducing the effectiveness of regulatory oversight.[252] In addition, some commenters suggested that the agencies did not provide sufficient justification to support the proposed changes to the exclusion.[253]

After reviewing the comments received, the agencies are adopting the liquidity management exclusion substantially as proposed, but with a modification to permit the use of non-deliverable cross-currency swaps. The agencies recognize the various types of financial instruments that can be used by a banking entity for liquidity management as noted by commenters. However, the agencies continue to believe, as stated in the proposal, that the purpose of the expansion is to streamline compliance for banking entities operating in foreign

[232] *See* 79 FR at 5555.

[233] *See* 7 U.S.C. 1a(24) and 1a(25).

[234] *See* proposed rule § ▮▮.3(e)(3).

[235] *See* 83 FR at 33451–52

[236] *See id.*

[237] *See, e.g.,* ISDA; Goldman Sachs; ABA; SIFMA; IIB; BPI; GFMCA; CFA; New England Council, CCMC; Capital One et al., FSF; and State Street.

[238] *See, e.g.,* ISDA; ABA; FSF; New England Council; CCMC; Capital One et al.; Goldman Sachs; SIFMA; IIB; Credit Suisse; and State Street.

[239] *See* ISDA.

[240] *See, e.g.,* Global Financial Markets Association (GFMA) (noting that certain non-deliverable financial instruments are also used for liquidity management purposes); SIFMA; State Street; JBA; ABA; BPI; IIB; and Credit Suisse.

[241] *See, e.g.,* FSF; Capital One et al.; IIB; and JBA.

[242] *See, e.g.,* IIB and State Street.

[243] *See, e.g.,* Capital One et al.; BPI; JBA; SIFMA; CCMC; and FSF.

[244] *See, e.g.,* ISDA; KeyCorp; IIB; CCMC; SIFMA; and Goldman Sachs.

[245] *See, e.g.,* FSF and Credit Suisse.

[246] *See, e.g.,* SIFMA and Goldman Sachs.

[247] *See, e.g.,* BPI; IIB; and FSF.

[248] *See* ABA.

[249] *See, e.g.,* Volcker Alliance; Data Boiler; NAFCU; Public Citizen; CAP; Occupy the SEC; and Merkley.

[250] *See* Bean.

[251] *See* Volcker Alliance.

[252] *See* Data Boiler.

[253] *See, e.g.,* Public Citizen and Bean.

jurisdictions.[254] Thus, the final rule expands the liquidity management exclusion to permit the purchase or sale of foreign exchange forwards (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swaps (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), and cross-currency swaps [255] entered into by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan.[256]

In response to commenters' concerns that physically settled cross-currency swaps are not available for some currencies (*e.g.,* due to currency controls), the exclusion also encompasses non-deliverable cross-currency swaps. For currencies where physically settled cross-currency swaps are not available, a banking entity may have had to engage in procedures such as using spot transactions or holding currency at foreign custodians, which could be inefficient. Allowing banking entities to use non-deliverable cross-currency swaps can provide greater flexibility in conducting liquidity management in these situations. Even though physically settled cross-currency swaps are available in many currencies, the agencies believe it is appropriate to allow non-deliverable cross-currency swaps to be used for liquidity management in all currencies. Requiring physical settlement for some cross-currency swaps but not others would make the exclusion more difficult for banking entities to use and for the agencies to monitor, particularly if currency controls change, causing the list of currencies for which physical settlement is permitted to change. These administrative hurdles would negate many of the benefits of allowing the use of non-deliverable cross-currency swaps.

Regarding the assertion that banking entities could meet their liquidity needs in the securities markets, the agencies have found that, to the contrary, foreign exchange forwards, foreign exchange swaps, and cross-currency swaps are often used by trading desks to manage liquidity both in the United States and in foreign jurisdictions. As foreign branches and subsidiaries of U.S. banking entities often have liquidity requirements mandated by foreign jurisdictions, U.S. banking entities often use foreign exchange products to address currency risk arising from holding this liquidity in foreign currencies. Thus, these foreign exchange products are important for liquidity management and should be included in the expansion of the liquidity management exclusion.

The agencies believe that adding foreign exchange forwards, foreign exchange swaps, and cross-currency swaps to the exclusion addresses the primary liquidity management needs for foreign entities, and therefore are declining to expand the exclusion to other products as suggested by some commenters. While some commenters asserted that further expanding the liquidity management exclusion would streamline compliance without introducing additional safety and soundness or proprietary trading concerns, the agencies believe that the range of financial instruments that will qualify for the exclusion under the final rule will be sufficient for managing banking entities' liquidity risks.

The final rule permits a banking entity to purchase or sell foreign exchange forwards, foreign exchange swaps, and cross-currency swaps to the same extent that a banking entity may purchase or sell securities under the liquidity management exclusion in the 2013 rule, and the conditions that apply for securities transactions also apply to transactions in foreign exchange forwards, foreign exchange swaps, and cross-currency swaps.[257]

The agencies acknowledge that, as stated in the proposal, cross-currency swaps generally are more flexible in their terms, may have longer durations, and may be used to achieve a greater variety of potential outcomes, as compared to foreign exchange forwards and foreign exchange swaps.[258] However, the agencies believe that the requirement to conduct liquidity management in accordance with a documented liquidity management plan appropriately limits the use of cross-currency swaps to activities conducted for liquidity management purposes, and therefore banking entities' use of these swaps should not adversely affect currency markets, as one commenter warned. Under the plan, the purpose of the transactions must be liquidity management. The timing of purchases and sales, the types and duration of positions taken and the incentives provided to managers of these purchases and sales must all indicate that managing liquidity, and not taking short-term profits (or limiting short-term losses), is the purpose of these activities. Thus, to be in compliance with the plan, cross-currency swaps must be used principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes.[259]

Regarding the assertion from some commenters that the compliance-related requirements for the liquidity management exclusion are opaque or unnecessarily prescriptive, the agencies believe it is important to retain these requirements in order to provide clarity in administration of the rule and to protect against potential misuse of the liquidity management exclusion for proprietary trading. As noted above, the documented liquidity management plan, required under the 2013 rule and retained in the final rule,[260] is a key element in assuring that liquidity management is the purpose of the relevant transactions. The agencies do not believe that the final rule will stand as an obstacle to or otherwise impair the ability of banking entities to manage their liquidity risks. Although other changes to the 2013 rule in the final rule, such as the elimination of Appendix B, reflect efforts to tailor compliance obligations, the agencies believe it is important to be explicit in maintaining targeted compliance requirements for specific provisions of the final rule, such as the liquidity management exclusion.

The agencies believe that the six required elements of the liquidity management plan help to mitigate commenters' concerns that the proposal would have encouraged banking entities to exclude impermissible trades as liquidity management or increase risk-taking. Under the liquidity management plan required by the final rule, the exclusion does not apply to activities undertaken with the stated purpose or effect of hedging aggregate risks incurred by the banking entity or its affiliates related to asset-liability mismatches or other general market risks to which the entity or affiliates may be exposed. Further, the exclusion does not apply to any trading activities

[254] *See* 83 FR at 33451–52.

[255] As proposed, the final rule defines a cross-currency swap as a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon for when the swap is entered. This definition is consistent with regulations pertaining to margin and capital requirements for covered swap entities, swap dealers, and major swap participants. *See* 12 CFR 45 ■■.2; 12 CFR 237.2; 12 CFR 349.2; 17 CFR 23.151.

[256] *See* final rule § ■■.3(d)(3).

[257] *See* § ■■.3(e)(3)(i)–(vi) of the final rule.

[258] *See* 83 FR at 33452.

[259] *See* § ■■.3(d)(3)(ii) of the final rule.

[260] *See* § ■■.3(d)(3).

that expose banking entities to substantial risk from fluctuations in market values, unrelated to the management of near-term funding needs, regardless of the stated purpose of the activities.[261]

This final rule also includes a change to one of the liquidity management exclusion's requirements. The 2013 rule requires that activity conducted under the liquidity management exclusion be consistent with applicable ''supervisory requirements, guidance, and expectations.'' [262] Consistent with changes elsewhere in the final rule and with the Federal banking agencies' Interagency Statement Clarifying the Role of Supervisory Guidance,[263] the agencies are removing references to guidance and expectations from the regulatory text of the liquidity management exclusion. In addition, the final rule includes conforming changes that reflect the addition of foreign exchange forwards, foreign exchange swaps, and cross-currency swaps as permissible contracts in conjunction with the other criteria under the exclusion.[264]

ii. Transactions To Correct Bona Fide Trade Errors

The proposal included an exclusion from the definition of proprietary trading for trading errors and subsequent correcting transactions.[265] As discussed in the proposal, the exclusion was intended to address situations in which a banking entity erroneously executes a purchase or sale of a financial instrument in the course of conducting a permitted or excluded activity. For example, a trading error may occur when a banking entity is acting solely in its capacity as an agent, broker, or custodian pursuant to § ▮▮.3(d)(7) of the 2013 rule, such as by trading the wrong financial instrument, buying or selling an incorrect amount of a financial instrument, or purchasing rather than selling a financial instrument (or vice versa). To correct such errors, a banking entity may need to engage in a subsequent transaction as principal to fulfill its obligation to deliver the customer's desired financial instrument position and to eliminate any principal exposure that the banking entity acquired in the course of its effort to deliver on the customer's original request. As the proposal noted, banking entities have expressed concern that, however, under the 2013 rule, the initial trading error and any corrective transactions could, depending on the facts and circumstances involved, fall within the proprietary trading definition if the transaction is covered by any of the prongs of the trading account definition and is not otherwise excluded pursuant to a different provision of the rule.

To address this concern, the agencies proposed a new exclusion from the definition of proprietary trading for trading errors and subsequent correcting transactions. The proposal noted that the availability of this exclusion would depend on the facts and circumstances of the transactions, such as whether the banking entity made reasonable efforts to prevent errors from occurring, or identified and corrected trading errors in a timely and appropriate manner. The proposed exclusion required that banking entities, once they identified purchases or sales made in error, transfer the financial instrument to a separately managed trade error account for disposition. The proposal would have required that this separately managed trade error account be monitored and managed by personnel independent from the traders responsible for the error, and that banking entities monitor and manage trade error corrections and trade error accounts.

The majority of commenters generally supported the proposed exclusion for trade errors.[266] Some commenters noted that, consistent with operational risk management practices, bona fide trade error activity is separately managed and classified as an operational loss when there is a loss event or a ''near miss'' when error activity results in a gain.[267] Many commenters urged the agencies not to mandate a separately managed trade error account, but to permit banking entities to resolve trading errors in accordance with internal policies and procedures to avoid duplicative resolution systems and unnecessary regulatory costs.[268] One commenter argued that error trades are clearly outside the scope of activities meant to be prohibited by the statute, so it should not be necessary to include any additional documentation or administrative requirements related to them.[269] One comment letter requested that the agencies clarify that the exclusion covers both pre-settlement trade errors (where the error is identified and corrected prior to being settled in the client's account and is settled in a separately managed trade error account) and post-settlement trade errors (where the trade error is settled in and posted directly to the client's account).[270]

One commenter supported providing an exclusion for bona fide error trades, but suggested certain changes to the proposed exclusion.[271] This commenter expressed concern that the proposed exclusion did not provide sufficient protections to ensure that banking entities correct errors in a timely and comprehensive manner and do not use the exclusion to facilitate directional exposures. To this end, the commenter recommended requiring banking entities to establish reasonably designed controls, including periodic exception reports containing certain specified fields. These reports, the commenter argued, should be provided to independent personnel in the second line-of-defense, including compliance and risk personnel, and escalated internally in accordance with the banking entity's internal policies and procedures. The commenter also recommended requiring periodic error trade testing and audits conducted by the second line-of-defense.

One commenter argued against a blanket exclusion for error trades, and urged the agencies to require any profit from error trades be forfeited to the U.S. Treasury, thereby removing any incentive for a banking entity to erroneously classify intentional financial positions as error trades.[272] Another commenter argued that the proposal did not adequately explain or provide sufficient data to justify the necessity of providing an exclusion for error trades, and that the exclusion could be used to evade the prohibition on proprietary trading.[273]

After weighing the comments received, the agencies are excluding from the definition of ''proprietary trading'' any purchase or sale of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or

[261] *See* 79 FR at 5555.

[262] *See* 2013 rule § ▮▮.3(d)(3)(vi).

[263] Interagency Statement Clarifying the Role of Supervisory Guidance (Sept. 11, 2018; *https://www.occ.gov/news-issuances/news-releases/2018/nr-ia-2018-97a.pdf, https://www.fdic.gov/news/news/financial/2018/fil18049.html, https://www.federalreserve.gov/supervisionreg/srletters/sr1805.htm*). The final rule similarly removes references to ''guidance'' from subparts A and C.

[264] The term ''financial instruments'' is substituted for the term ''securities'' when referring to what contracts are permitted under the exclusion.

[265] *See* 83 FR at 33452–53.

[266] *See, e.g.,* ABA; BB&T; Capital One et al.; BPI; FSF; CFA; and JBA.

[267] *See, e.g.,* ABA; BB&T; BPI; Capital One et al.; and FSF.

[268] *See, e.g.,* ABA; Credit Suisse; FSF; JBA; and SIFMA.

[269] *See* SIFMA.

[270] *See* Capital One et al.

[271] *See* Better Markets.

[272] *See* Public Citizen.

[273] *See* CAP.

excluded activity or is a subsequent transaction to correct such an error.[274] The agencies do not believe bona fide trading errors and correcting transactions are proprietary trading. Under the 2013 rule, trading errors and subsequent transactions to correct such errors could trigger the short-term intent prong's 60-day rebuttable presumption and thus could be considered to be presumptively within the trading account. In addition, trading errors and correcting transactions could be within the definition of proprietary trading under the market risk prong or dealer prong. While the final rule eliminates the 2013 rule's 60-day rebuttable presumption,[275] the agencies believe it is useful and appropriate to clarify in the final rule that trading errors and subsequent correcting transactions are not proprietary trading because banking entities do not enter into these transactions principally for the purpose of selling in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements).[276] Rather, the principal purpose of a trading error correction is to remedy a mistake made in the ordinary course of the banking entity's permissible activities.[277] Accordingly, the agencies are adopting this exclusion to provide clarity regarding bona fide trading errors and subsequent correcting transactions.

Consistent with feedback from several commenters,[278] the exclusion in the final rule does not require banking entities to transfer erroneously purchased (or sold) financial instruments to a separately managed trade error account for disposition. The agencies agree that this requirement could have resulted in duplicative resolution systems and imposed undue regulatory costs, which are not appropriate in light of the narrow class of bona fide trading errors that fall within the exclusion. As with all exclusions and permitted trading activities, the agencies intend to monitor use of this exclusion for evasion. For example, the magnitude or frequency of errors could indicate that the trading activity is inconsistent with this exclusion.

The agencies have considered comments suggesting that the agencies should impose on banking entities certain reporting, auditing, and testing requirements specifically related to trade error transactions.[279] As noted above, the agencies believe mandating requirements such as these could lead to undue costs for banking entities, which are not appropriate in light of the narrow class of bona fide trading errors that fall within the exclusion. Such bona fide trade errors and subsequent correcting transactions do not fall within the statutory definition of ''proprietary trading'' because they lack the requisite short-term intent. Accordingly, the agencies do not find it necessary to impose additional requirements with respect to such activities. Further, the agencies do not agree that any profits resulting from trade error transactions should be remitted to the U.S. Treasury.

iii. Matched Derivative Transactions

The proposal requested comment on the treatment of loan-related swaps between a banking entity and customers that have received loans from the banking entity.[280] The proposal explained that, in a loan-related swap transaction, a banking entity enters into a swap with a customer in connection with the customer's loan and contemporaneously offsets the swap with a third party. The swap with the customer is directly related to the terms of the customer's loan.[281] In one typical type of loan-related swap, a banking entity seeks to make a floating-rate loan to a customer that could have the benefit to the banking entity of reducing the banking entity's interest rate risk, but the customer would prefer to have the economics of a fixed-rate loan.[282] To achieve a result that addresses these divergent preferences, the banking entity makes a floating-rate loan to the customer and contemporaneously or nearly contemporaneously enters into a floating rate to fixed rate interest rate swap with the same customer and an offsetting swap with another counterparty.[283] As a result, the customer receives economic treatment similar to a fixed-rate loan.[284] The banking entity has entered into the preferred floating rate loan, provided the customer with the customer's preferred fixed rate economics though the interest rate swap with the customer and offset its market risk exposure from the customer-facing interest rate swap through a swap with another counterparty.[285]

Loan-related swaps have presented a compliance challenge particularly for smaller non-dealer banking entities.[286] These banking entities may enter into loan-related swaps infrequently, and the decision to do so tends to be situational and dependent on changes in market conditions as well as on the interaction of a number of factors specific to the banking entity, such as the nature of the customer relationship.[287]

The proposal sought comment on whether loan-related swaps should be excluded from the definition of proprietary trading, exempted from the prohibition on proprietary trading, or permitted under the exemption for market making-related activities.[288] The proposal also asked whether other types of swaps, such as end-user customer-driven swaps that are used by a customer to hedge commercial risk should be treated the same way as loan-related swaps.[289] The proposal also requested comment as to whether it is appropriate to permit loan-related swaps to be conducted pursuant to the exemption for market making-related activities where the frequency with which a banking entity executes such swaps is minimal but the banking entity remains prepared to execute such swaps when a customer makes an appropriate request.[290]

Most commenters supported allowing loan-related swaps, either by adopting an exclusion from the definition of proprietary trading,[291] creating a new exemption for loan-related swaps,[292] or clarifying that banking entities could enter into loan-related swaps under existing exemptions.[293] The majority of these commenters supported explicitly excluding loan-related swaps from the definition of proprietary trading.[294] These commenters noted that loan-related swap transactions generally do not fall within the statutory definition of trading account and that these

274 Final rule § ▮▮.3(d)(10).

275 *See* final rule § ▮▮.3(b)(4).

276 *See* 12 U.S.C. 1851(h)(6).

277 *See, e.g.,* BPI and FSF.

278 *See, e.g.,* ABA; Credit Suisse; FSF; JBA; and SIFMA.

279 *See* Better Markets.

280 *See* 83 FR at 33462–64.

281 *See id.* at 33462.

282 *Id.*

283 *Id.*

284 *Id.*

285 *Id.* In this example, the banking entity retains the counterparty risk from both swaps. However, depending on the type of swap and the particular transaction, the banking entity may be able to manage the counterparty risk, for example, by clearing the transaction at a clearing agency or derivatives clearing organization acting as a central counterparty, as applicable.

286 *Id.*

287 *Id.* at 33463.

288 *Id.*

289 *Id.* at 33464.

290 *Id.* at 33463.

291 *See, e.g.,* BOK; ABA; Covington & Burling LLP (Covington); JBA; Chatham; Credit Suisse; BPI; SIFMA; IIB, Covington; Arvest; IIB; KeyCorp; and Capital One et al.

292 *See, e.g.,* Covington and BPI.

293 *See, e.g.,* Covington; BPI; SIFMA; Credit Suisse; and BB&T.

294 *See, e.g.,* BOK; ABA; Covington; JBA; Chatham; Credit Suisse; BPI; SIFMA; IIB, Covington; Arvest; IIB; KeyCorp; and Capital One et al.

transactions are important risk-mitigating activities.[295] Commenters stated that providing an exclusion or permitted activity exemption for loan-related swaps would prevent section 13 of the BHC Act from having an unintended chilling effect on an important and prudent lending-related activity.[296] Commenters also stated that these types of swap transactions are important tools that facilitate bank customers' ability to manage their risks.[297] One commenter opposed providing an exclusion for loan-related swaps, arguing that these activities instead should be conducted under the risk-mitigating hedging exemption.[298]

Two commenters requested that the agencies adopt a permitted activity exemption for loan-related swaps or revise the existing exemption for market making-related activities if the agencies do not explicitly exclude loan-related swaps from the definition of proprietary trading.[299] In addition, two commenters suggested that the exemption for riskless principal transactions in § ▮▮.6(c)(2) of the 2013 rule could cover loan-related swaps.[300] These commenters and two others suggested that excluding loan-related swaps from the definition of proprietary trading would be more effective than adopting a new permitted activity exemption or relying on an existing permitted activity exemption.[301]

Two commenters argued that banking entities should be allowed to engage in loan-related swaps using the exemption for market making-related activities.[302] Several other commenters asserted that the market-making exemption is a poor fit for loan-related swaps and that the market-making exemption's requirements were unduly burdensome with respect to this activity, particularly for smaller banking entities.[303]

Several commenters supported excluding additional derivatives activities from the definition of proprietary trading, such as customer-driven matched-book trades that enable customers to hedge commercial risk regardless of whether the swaps are related to a loan.[304] Commenters noted that such customer-driven matched-book trades do not expose banking entities to risk other than counterparty credit risk.[305] Moreover, these trades reduce risks to the bank's customer and thus also reduce the risk of the banking entity's loans to that customer.[306]

Three commenters requested that the exclusion be expanded to cover instances where a banking entity enters into a loan-related swap with a customer but does not offset that swap with a third party.[307]

One commenter urged the agencies to adopt a definition of loan-related swaps that is substantially similar to the definition adopted by the CFTC for swaps executed in connection with originating loans to customers, and to include in the definition, the derivatives transaction entered into with a dealer to offset the risk of the customer-facing swap.[308] Another commenter opposed using the CFTC's definition, noting that the CFTC's definition would not address commodity-based matched-book derivative transactions.[309] One commenter recommended defining ''customer-facing loan-related swap'' to mean any swap with a customer or affiliate thereof in which the rate, asset, liability, or other notional item underlying the swap with the customer or affiliate thereof is, or is directly related to, a financial term of a loan or other credit facility with the customer or affiliate thereof (including, without limitation, the loan or other credit facility's duration, rate of interest, currency or currencies, or principal amount).[310] The same commenter stated that the exclusion should not include a timing requirement with respect to the offsetting swap or, if a timing condition is included, the banking entity should be required to enter into the offsetting swap ''contemporaneously or substantially contemporaneously'' with the customer-facing loan-related swap.[311]

After considering the comments received, the agencies are excluding from the definition of ''proprietary trading'' entering into a customer-driven swap or a customer-driven security-based swap and a matched swap or security-based swap if: (i) The transactions are entered into contemporaneously; (ii) the banking entity retains no more than minimal price risk;[312] and (iii) the banking entity is not a registered dealer, swap dealer, or security-based swap dealer.[313] The agencies are adopting this exclusion to provide greater certainty for non-dealer banking entities that engage in these customer-driven matched-book swap transactions.

Under the 2013 rule, these customer-driven matched swap transactions could trigger the short-term intent prong's rebuttable presumption and thus would be presumptively within the trading account. Although the agencies are eliminating the 2013 rule's rebuttable presumption,[314] the agencies believe that it is nevertheless useful and appropriate to clarify in the final rule that these customer-driven matched swap transactions are not proprietary trading because banking entities do not enter into these transactions principally for the purpose of selling in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements).[315] For this reason, the agencies are providing an exclusion for these activities from the proprietary trading definition rather than requiring them to be conducted pursuant to the risk-mitigating hedging exemption, as one commenter suggested.

The agencies believe that adopting this exclusion will reduce costs for non-dealer banking entities and avoid disrupting a common and traditional banking service provided to small and medium-sized businesses. This exclusion will provide a greater degree of certainty that these customer-driven matched swap transactions are outside the scope of the final rule.

Consistent with feedback received from commenters,[316] the exclusion in the final rule is not limited to loan-related swaps.[317] Thus, the exclusion in the final rule could apply to a swap with a customer in connection with the

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[295] *See, e.g.,* BOK; ABA; Covington; JBA; Chatham; Arvest; and IIB.

[296] *See, e.g.,* Covington and Credit Suisse.

[297] *See, e.g.,* Arvest and BOK.

[298] *See* Data Boiler.

[299] *See, e.g.,* Covington and BPI.

[300] *See, e.g.,* SIFMA and Credit Suisse.

[301] *See, e.g.,* Covington; BPI; SIFMA; and Credit Suisse.

[302] *See, e.g.,* BB&T and Credit Suisse (Credit Suisse noted, however, that an exclusion would be preferable to using the market-making exemption).

[303] *See, e.g.,* IIB; Covington; SIFMA; Capital One et al.; BPI; and B&F.

[304] *See, e.g.,* BOK; JBA; ABA; Capital One et al.; and KeyCorp.

[305] *See, e.g.,* BOK and ABA.

[306] *See, e.g.,* BOK.

[307] *See, e.g.,* ABA; Arvest; and IIB.

[308] *See* Chatham.

[309] *See* BOK.

[310] *See* Covington.

[311] *See id.*

[312] Price risk is the risk of loss on a fair-value position that could result from movements in market prices.

[313] Final rule § ▮▮.3(d)(11).

[314] *See* final rule § ▮▮.3(b)(4).

[315] *See* 12 U.S.C. 1851(h)(6).

[316] *See, e.g.,* BOK; JBA; ABA; Capital One et al.; and KeyCorp.

[317] As a result, the agencies are not adopting a definition of ''loan-related swap'' substantially similar to the definition adopted by the CFTC for swaps executed in connection with originating loans to customers, as requested by one customer. *See* Chatham. The agencies also note that this exclusion does not impact the ''insured depository institution swaps in connection with originating loans to customers'' provisions in the CFTC's definition of ''swap dealer.'' *See* 17 CFR 1.3, Swap dealer, paragraphs (4)(i)(C) and (5). Additionally, this exclusion does not affect any other aspects of the ''swap dealer'' definition in CFTC regulations, or how that term is interpreted by the CFTC.

customer's end-user activity (provided that all the terms of the exclusion are met). For example, a corn farmer is a customer of a non-dealer banking entity. To manage its risk with respect to the price of corn, the corn farmer enters into a swap on corn prices with the banking entity. The banking entity contemporaneously enters into a corn-price swap with another counterparty to offset the price risk of the swap with the corn farmer. The swap with the corn farmer and the offsetting swap with the counterparty have matching terms such that the banking entity retains no more than minimal price risk. The agencies have determined that it is appropriate to exclude these types of transactions from the definition of proprietary trading because, like matched loan-related swaps discussed above, banking entities do not enter into these customer-driven transactions principally for the purpose of selling in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements).[318]

Several conditions must be met for the exclusion to apply.[319] The exclusion applies only to banking entities that are not registered dealers, swap dealers, or security-based swap dealers. This approach is consistent with feedback from commenters noting that primarily smaller banking entities have faced compliance challenges with respect to customer-driven swaps activities.[320] Banking entities that are registered dealers, swap dealers, or security-based swap dealers generally engage in these activities on a more regular basis and therefore have been able to conduct their derivatives activities pursuant to the exemption for market making-related activities. Although some commenters argued that the exemption for market making-related activities is too burdensome to apply to this type of activity,[321] the agencies note that the final rule streamlines certain requirements of that exemption.[322]

The exclusion only applies to transactions where one of the two matched swaps or security-based swaps is customer-driven, in that the transaction is entered into for a customer's valid and independent business purposes. In addition, the hedging swap or hedging security-based swap must match the customer-driven swap or customer-driven security-based swap. The banking entity may retain no more than minimal price risk between the two swaps or security-based swaps.[323] Finally, the banking entity must enter into the customer-driven swap or customer driven security-based swap contemporaneously with the matching swap or matching security-based swap.[324] These conditions carve out from the exclusion activities whose principal purpose is resale in the near term.[325] For example, if a banking entity entered into a hedging swap whose economic terms did not match the terms of the customer-driven swap, the banking entity would be exposed to price risk and could be speculating on short-term price movements. Similarly, if a banking entity waited multiple days between entering into a customer-driven swap and entering into the offsetting swap, the banking entity could be speculating on short-term price movements during the unhedged period of the swap transaction. In either case, the banking entity could be engaged in proprietary trading.[326] The requirements in the final rule's exclusion are intended to limit the exclusion to activities that the agencies have determined lack the requisite short-term trading intent.

The agencies have considered the comments requesting an exclusion for unmatched loan-related swaps and determined that such an exclusion is not necessary in the final rule.[327] For example, if a bank provides a loan to a customer and enters into a swap with the customer related directly to the terms of that loan but does not offset that customer-driven swap with a third-party, the exclusion does not apply. Although the exclusion may not apply, the agencies believe that this type of activity is unlikely to be within the trading account under the final rule, particularly because the agencies are not adopting the proposed accounting prong. Entering into such a loan-related swap would be proprietary trading only if the purchase or sale of the swap is principally for short term trading purposes or is otherwise within the definition of trading account.[328]

iv. Hedges of Mortgage Servicing Rights or Assets

The final rule excludes from the definition of proprietary trading any purchase or sale of one or more financial instruments that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy. The agencies are adopting this exclusion to clarify the scope of the prohibition on proprietary trading and to provide parity between banking entities that are subject to the market risk capital prong and banking entities that are subject to the short-term intent prong.

Section 13 of the BHC Act defines "trading account" to mean "any account used for acquiring or taking positions in . . . securities and instruments . . . principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)," and any such other accounts that the agencies determine by rule. The purchase or sale of a financial instrument as part of a bona fide mortgage servicing rights or mortgage servicing asset hedging program is not within the statutory definition of "trading account" under the short-term intent prong because the principal purpose of such a purchase or sale is hedging rather than short-term resale for profit.

The agencies have determined to explicitly exclude this type of hedging activity from the definition of "proprietary trading" to provide greater clarity to banking entities that are subject to the short-term intent prong in light of changes made elsewhere in the final rule. Under the final rule, banking entities that are subject to the market risk capital prong (or that elect to apply the market risk capital prong) are not subject to the short-term intent prong. The market risk capital rule explicitly excludes intangibles, including servicing assets, from the definition of "covered position." Financial instruments used to hedge mortgage servicing rights or assets generally would not be captured under the market risk capital prong. Therefore, absent an explicit exclusion, banking entities that are subject to the market risk capital prong have more certainty than banking entities that are subject to the short-term intent prong that the purchase or sale of a financial instrument to hedge mortgage servicing rights or mortgage servicing assets is not proprietary

[318] *See* 12 U.S.C. 1851(h)(6).

[319] If a transaction does not satisfy all of the conditions of the exclusion but is not within the definition of trading account, the transaction would not constitute proprietary trading.

[320] *See, e.g.,* Chatham; ABA; and Covington.

[321] *See, e.g.,* IIB; Covington; SIFMA; Capital One et al.; BPI; and B&F.

[322] *See* final rule § ▮▮.4(b).

[323] The banking entity would retain minimal price risk if the economic terms of the two swaps (*e.g.,* index, amount, maturity, and underlying reference asset or index) match.

[324] The exclusion only applies to transactions where the customer-driven swap or customer-driven security-based swap is offset by a matching swap or security-based swap on a one-for-one basis. The exclusion does not apply to portfolio-hedged derivatives transactions.

[325] *See* 12 U.S.C. 1851(h)(6).

[326] Whether the banking entity is actually engaged in impermissible proprietary trading would depend on the facts and circumstances of the particular transaction.

[327] *See* ABA and Arvest.

[328] *See* final rule § ▮▮.3(b).

trading. The agencies are explicitly excluding mortgage servicing rights and mortgage servicing asset hedging activity to provide banking entities that are not subject to the market risk capital prong (or that elect to apply the market risk capital prong) the same degree of certainty. As described in part IV.B.1.a.iii of this **SUPPLEMENTARY INFORMATION**, the final rule seeks to provide parity between smaller banking entities that are not subject to the market risk capital rule and larger banking entities with active trading businesses that are subject to the market risk capital prong. The agencies believe an express exclusion for mortgage servicing rights and mortgage servicing hedging activity is useful in light of the revision to the trading account definition that applies the short-term intent prong only to banking entities that are not subject to the market risk capital prong.

This exclusion applies only to bona fide hedging activities, conducted in accordance with a documented hedging strategy. This requirement will assist the agencies in monitoring for evasion or abuse. In addition, the agencies note that banking entities' mortgage servicing activities and related hedging activities remain subject to applicable law and regulation, including the Federal banking agencies' safety and soundness standards.

v. Financial Instruments That Are Not Trading Assets or Trading Liabilities

The final rule excludes from the trading account any purchase or sale of a financial instrument that does not meet the definition of ''trading asset'' or ''trading liability'' under the banking entity's applicable reporting form. As with the exclusion for hedges of mortgage servicing rights or assets, the agencies are adopting this exclusion to clarify the scope of the prohibition on proprietary trading and to provide parity between banking entities that are subject to the market risk capital prong (or that elect to apply the market risk capital prong) and banking entities that are subject to the short-term intent prong.

The agencies have determined to exclude the purchase or sale of assets that would not meet the definition of trading asset or trading liability from the definition of ''proprietary trading'' to provide greater clarity to banking entities that are subject to the short-term intent prong. As described above, under the final rule, banking entities that are subject to the market risk capital prong (or that elect to apply the market risk capital prong) are not subject to the short-term intent prong.[329] Under the market risk capital prong, a purchase or sale of a financial instrument is within the trading account if it would be both a covered position and trading position under the market risk capital rule. In general, a position is a covered position under the market risk capital prong if it is a trading asset or trading liability (whether on- or off-balance sheet).[330] Thus, the exclusion for financial instruments that are not ''trading assets and liabilities'' extends the same certainty to banking entities subject to the short-term intent prong as is provided by operation of the market risk capital prong.

One commenter recommended that the agencies modify the short-term intent prong to include only financial instruments that meet the definition of trading assets and liabilities and that are held for the purpose of short-term trading.[331] The agencies have determined that including only financial instruments that meet the definition of trading assets and liabilities (by excluding instruments that do not meet this definition) is appropriate because the trading asset and liability definitions used for regulatory reporting purposes incorporate substantially the same short-term trading standard as the short-term intent prong and section 13 of the BHC Act. The Call Report and FR Y–9C provide that trading activities typically include, among other activities, acquiring or taking positions in financial instruments ''principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements.'' [332] This language is substantially identical to the statutory definition of trading account, which applies to any account used for acquiring or taking positions in financial instruments ''principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements) ....'' [333] Therefore, excluding any purchase or sale of a financial instrument that would not be classified as a trading asset or trading liability on these applicable reporting forms is consistent with the statutory definition of trading account in section 13 of the BHC Act. This exclusion is expected to provide additional clarity to banking entities subject to the short-term intent prong, while also better aligning the compliance program requirements with the scope of activities subject to section 13 of the BHC Act.

This exclusion applies to any purchase or sale of a financial instrument that does not meet the definition of ''trading asset'' or ''trading liability'' under the applicable reporting form as of the effective date of this final rule. The final rule references the reporting forms in effect as of the final rule's effective date to ensure the scope of the exclusion remains consistent with the statutory trading account definition. Because the reporting forms are used for many purposes and are generally based on generally accepted accounting principles, future revisions to the reporting forms could define ''trading asset'' and ''trading liability'' inconsistently with the ''trading account'' definition in section 13 of the BHC Act. Further, tying the exclusion to the reporting forms currently in effect will provide greater certainty to banking entities. If the scope of the exclusion were subject to change based on revisions to the applicable reporting forms, it could require banking entities to make corresponding changes to compliance systems to remain in compliance with the rule, which could result in disruption both for banking entities and the agencies. Accordingly, the final rule excludes any purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form as of the effective date of the final rule.

c. Trading Desk

The 2013 rule applies certain requirements at the ''trading desk''-level of organization.[334] The 2013 rule defined ''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.[335]

As noted in the proposal, some banking entities had indicated that, in practice, the 2013 rule's definition of trading account had led to uncertainty regarding the meaning of ''smallest discrete unit.'' [336] In addition, banking

[329] *See* final rule § ■ ■.3(b).

[330] *See* 12 CFR 3.202(b); 12 CFR 217.202(b); 12 CFR 324.202(b). In addition, the market risk capital rule's ''covered position'' definition expressly includes and excludes additional classes of instruments.

[331] *See* SIFMA.

[332] *See, e.g.,* Instructions for Preparation of Consolidated Reports of Condition and Income, FFIEC 031 and FFIEC 041, Schedule RC–D; Instructions for Preparation of Consolidated Financial Statements for Holding Companies, Reporting Form FR Y–9C, Schedule HC–D.

[333] 12 U.S.C. 1851(h)(6).

[334] *See* 2013 rule §§ ■ ■.4, ■ ■.5, App. A., App. B; final rule §§ ■ ■.4, ■ ■.5, App. A.

[335] 2013 rule § ■ ■.3(e)(13).

[336] *See* 83 FR at 33453.

entities had communicated that this definition has caused confusion and duplicative compliance and reporting efforts for banking entities that also define trading desks for purposes unrelated to the 2013 rule, including for internal risk management and reporting and calculating regulatory capital requirements.[337] In response to these concerns, the proposal included a detailed request for comment on whether to revise the trading desk definition to align with the trading desk concept used for other purposes.[338] Specifically, the proposal requested comment on using a multi-factor trading desk definition based on the same criteria typically used to establish trading desks for other operational, management, and compliance purposes.[339]

Commenters that addressed the definition of ''trading desk'' generally supported revising the definition along the lines contemplated in the proposal.[340] Commenters asserted that the 2013 rule's ''smallest discrete unit language'' was subjective, ambiguous, and had been interpreted in different ways.[341] Commenters said that adopting a multi-factor definition would be preferable to the 2013 rule's definition because a multi-factor definition would align the definition of trading desk with other operational and managerial structures, whereas the 2013 rule's definition could be interpreted to require banking entities to designate certain units of organization as trading desks purely for purposes of the regulations implementing section 13 of the BHC Act.[342] One commenter supported the multi-factor definition in the proposal but recommended that the agencies should be required to approve the initial trading desk designations and any changes in trading desk designations.[343] One commenter said the agencies should allow the unit of the trading desk to be determined at the discretion of each financial institution [344] and another said it is not necessary to introduce complexity into how banking entities organize their internal operations.[345]

The final rule adopts a multi-factor definition that is substantially similar to the definition included in the request for comment in the proposal, except that the first prong has been revised and the reference to incentive compensation has been removed. This multi-factor definition will align the criteria used to define trading desk for purposes of the regulations implementing section 13 of the BHC Act with the criteria used to establish trading desks for other operational, management, and compliance purposes.

The definition of trading desk includes a new second prong that explicitly aligns the definition with the market risk capital rule.[346] The final rule provides that, for a banking entity that calculates risk-based capital ratios under the market risk capital rule, or a consolidated affiliate of a banking entity that calculates risk-based ratios under market risk capital rule, ''trading desk'' means a unit of organization that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof that is established by the banking entity or its affiliate for purposes of capital requirements under the market risk capital rule.[347] This change specifies that, for a banking entity that is subject to the market risk capital prong, the trading desk established for purposes of the market risk capital rule must be the same unit of organization that is established as a trading desk under the regulations implementing section 13 of the BHC Act. This prong of the trading desk definition is expected to simplify the supervisory activities of the Federal banking agencies that also oversee compliance with the market risk capital rule because the same unit of organization can be assessed for purposes of both the market risk capital rule and section 13 of the BHC Act, which will reduce complexity and cost for banking entities, and improve the effectiveness of the final rule. Together with providing firms with the flexibility to leverage existing or planned compliance programs in order to satisfy the elements of § ■■.20 as appropriate, the agencies expect aligning the definition of trading desk will minimize compliance burden on banking entities subject to both rules.

To further align the final rule's trading desk concept with the market risk capital rule, the final rule provides that a trading desk must be ''structured by the banking entity to implement a well-defined business strategy.'' [348] This further aligns the trading desk definition with the definition of ''trading desk'' in the Basel Committee's minimum capital requirements for market risk.[349] This change will ensure that banking entities that are subject to the market risk capital prong and banking entities that are not subject to the market risk capital prong have comparable trading desk definitions. In general, a well-defined business strategy typically includes a written description of a desk's objectives, including the economics behind its trading and hedging strategies, as well as the instruments and activities the desk will use to accomplish its objectives. A desk's well-defined business strategy may also include an annual budget and staffing plan and management reports.

Like the proposal, the final rule states that a trading desk is organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies. The final rule also states that a trading desk is characterized by a clearly-defined unit that: (i) Engages in coordinated trading activity with a unified approach to its key elements; (ii) operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits; (iii) submits compliance reports and other information as a unit for monitoring by management; and (iv) books its trades together. The agencies consider a unit to be ''clearly-defined'' if it meets these four factors.

The proposal included a multi-factor definition of trading desk that referenced incentive compensation as one defining factor. However, the banking agencies do not incorporate incentive compensation in regulatory capital rules generally, and therefore omitting this criterion would better align the trading desk definition between the market risk capital rule and the Volcker Rule. Thus, the final rule does not incorporate any reference to incentive compensation.[350]

The final rule does not require the agencies to approve banking entities'

[337] *See id.*

[338] *See id.*

[339] *See id.*

[340] *See, e.g.,* ABA; ISDA 1; CCMC; SIFMA 2; Goldman Sachs; FSF; JBA; and AFR.

[341] *See, e.g.,* ABA and CCMC.

[342] *See, e.g.,* ABA; ISDA 1; CCMC; SIFMA 2; Goldman Sachs; FSF; and JBA.

[343] *See* AFR.

[344] *See* JBA.

[345] *See* CCMC.

[346] Currently, the market risk capital rule does not include a definition of ''trading desk.'' However, the federal banking agencies expect to implement the Basel Committee's revised market risk capital standards, which do. *See* Basel Committee on Banking Supervision, ''Minimum Capital Requirements for Market Risk,'' MAR12 (Feb. 2019). The federal banking agencies expect their revised market risk capital rule will include a definition of ''trading desk'' that is consistent with the trading desk concept described in the ''Minimum Capital Requirements for Market Risk,'' and the multifactor approach in this final rule.

[347] *See* final rule § ■■.3(e)(13)(ii).

[348] Final rule § ■■.3(e)(13)(i)(A).

[349] *See* Basel Committee on Banking Supervision, Minimum Capital Requirements for Market Risk (Feb. 2019).

[350] *Compare* 83 FR at 33453 *with* final rule § ■■.3(e)(13)(i)(B).

initial trading desk designations and any changes in trading desk designations, as one commenter had recommended.[351] The agencies believe such an approval process is unnecessary for purposes of the final rule because the agencies intend to continue assessing banking entities' trading desk designations as part of the agencies' ongoing supervision of banking entities' compliance with the final rule as well as other safety and soundness regulations, as applicable. At the same time, the final rule does not allow the trading desk to be set completely at the discretion of the banking entity, as one commenter suggested.[352] The adopted definition will provide flexibility to allow banking entities to define their trading desks based on the same criteria typically used for other operational, management, and compliance purposes but would not be so broad as to hinder the agencies' or banking entities' ability to detect prohibited proprietary trading.

d. Reservation of Authority

The proposal included a reservation of authority that would have permitted an agency to determine, on a case-by-case basis, that any purchase or sale of one or more financial instruments by a banking entity for which it is the primary financial regulatory agency either is or is not for the trading account as defined in section 13(h)(6) of the BHC Act.[353] The preamble requested comment on whether such a reservation of authority would be necessary in connection with the proposed trading account definition, which would have focused on objective factors to define proprietary trading. The agencies explained that this approach may have produced results that were over- or under-inclusive with respect to the statutory trading account definition. The agencies further explained that the reservation of authority could provide appropriate balance by recognizing the subjective elements of the statute in light of the bright-line approach of the proposed accounting prong.

Two commenters supported adopting the reservation of authority.[354] Both of these commenters noted the importance of coordination and consistent application of the reservation of authority, particularly in instances where the primary financial regulatory agency may vary by legal entity within a firm.[355] One of these commenters suggested that the agencies keep such authority in reserve for use solely in those circumstances wherein poor management is putting an institution at risk of failure.[356]

The final rule does not include the proposed reservation of authority.[357] The revised trading account definition in the final rule retains a short-term intent standard that largely tracks the statutory standard.[358] Because the final trading account definition does not include the proposed accounting prong and is aligned with the statutory standard, the agencies do not find it necessary to retain a reservation of authority.

2. Section ▮▮.4: Permitted Underwriting and Market Making Related Activities

a. Current Exemptions for Underwriting and Market Making—Related Activities [359]

Section 13(d)(1)(B) of the BHC Act contains an exemption from the prohibition on proprietary trading for the purchase, sale, acquisition, or disposition of securities, derivatives, contracts of sale of a commodity for future delivery, and options on any of the foregoing in connection with underwriting or 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).[360] As the agencies noted when they adopted the 2013 rule, client-oriented financial services, which include underwriting, market making, and asset management services, are important to the U.S. financial markets and the participants in those markets.[361]

In particular, underwriters play a key role in facilitating issuers' access to funding, and are accordingly important to the capital formation process and to economic growth.[362] For example, underwriters can help reduce issuers' costs of capital by mitigating potential information asymmetries between issuers and their potential investors.[363] Similarly, market makers operate to help ensure that securities, commodities, and derivatives markets in the United States remain well-functioning by, among other things, providing important intermediation and liquidity.[364] At the same time, however, the agencies also recognized that providing appropriate latitude to banking entities to provide such client-oriented services need not and should not conflict with clear, robust, and effective implementation of the statute's prohibitions and restrictions.[365]

Accordingly, the 2013 rule follows a comprehensive, multi-faceted approach to implementing the statutory exemptions for underwriting and market making-related activities. Specifically, section ▮▮.4(a) of the 2013 rule implements the statutory exemption for underwriting and sets forth the requirements that banking entities must meet in order to rely on the exemption. Among other things, the 2013 rule requires that:

- The banking entity act as an ''underwriter'' for a ''distribution'' of securities and the trading desk's underwriting position be related to such distribution;
- The amount and types of securities in the trading desk's underwriting position be designed not to exceed RENTD, and reasonable efforts be made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;
- The banking entity has established and implements, maintains, and enforces an internal compliance program that is reasonably designed to ensure the banking entity's compliance with the requirements of the underwriting exemption, including reasonably designed written policies and procedures, internal controls, analysis, and independent testing identifying and addressing:

Æ The products, instruments, or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

Æ Limits for each trading desk, based on the nature and amount of the trading

[351] *See* AFR.

[352] *See* JBA.

[353] *See* 83 FR at 33454.

[354] *See, e.g.,* BB&T and CFA.

[355] *Id.*

[356] *See* CFA.

[357] *See* proposed rule § ▮▮.3(g).

[358] Although banking entities that are subject to the market risk capital prong are not subject to the short-term intent prong, the market risk capital prong incorporates a substantially similar short-term intent standard. As described above, the market risk capital rule's definition of trading position largely parallels the statutory definition of trading account, which in turn mirrors the language in the short-term intent prong.

[359] In contrast to the proposal, the discussions of the exemptions for underwriting and market making-related activity have been combined in order to avoid any unnecessary redundancy as well as any confusion that could arise to the extent there are differences in the way that otherwise identical provisions of those exemptions operate. However, the two exemptions remain separate and distinct. Banking entities seeking to rely on one or both exemptions are required to comply with the requirements and legal standards contained in each applicable exemption, and will continue to be required to do so following adoption of the final rule.

[360] 12 U.S.C. 1851(d)(1)(B).

[361] *See* 79 FR at 5615.

[362] *See* 79 FR at 5561 (internal footnotes omitted).

[363] *Id.*

[364] *See* 79 FR at 5576.

[365] *See* 79 FR at 5541.

desk's underwriting activities, including RENTD, on the (1) amount, types, and risk of the trading desk's underwriting position, (2) level of exposures to relevant risk factors arising from the trading desk's underwriting position, and (3) period of time a security may be held;

Æ Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

Æ Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

- The compensation arrangements of persons performing the banking entity's underwriting activities are designed not to reward or incentivize prohibited proprietary trading; and
- The banking entity is licensed or registered to engage in the activity described in the underwriting exemption in accordance with applicable law.

Similarly, section __.4(b) of the 2013 rule implements the statutory exemption for market making-related activities and sets forth the requirements that all banking entities must meet in order to rely on the exemption. Among other things, the 2013 rule requires that:

- The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;
- The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, RENTD, as required by the statute and based on certain factors and analysis specified in the rule;
- The banking entity has established and implements, maintains, and enforces an internal compliance program that is reasonably designed to ensure its compliance with the exemption for market making-related activities, including reasonably designed written policies and procedures, internal controls, analysis, and independent testing identifying and assessing certain specified factors;[366]
- To the extent that any required limit[367] established by the trading desk is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;
- The compensation arrangements of persons performing market making-related activities are designed not to reward or incentivize prohibited proprietary trading; and
- The banking entity is licensed or registered to engage in market making-related activities in accordance with applicable law.[368]

In the several years since the adoption of the 2013 rule, public commenters have observed that the significant and costly compliance requirements in the existing exemptions may unnecessarily constrain underwriting and market making without a corresponding reduction in the type of trading activities that the rule was designed to prohibit.[369] As the agencies noted in the proposal, implementation of the 2013 rule has indicated that the existing approach to give effect to the statutory standard of RENTD may be overly broad and complex, and also may inhibit otherwise permissible activity.[370]

Accordingly, the proposal was intended to tailor, streamline, and clarify the requirements that a banking entity must satisfy to avail itself of either exemption for underwriting or market making-related activities. In particular, the proposal intended to provide a clearer way to determine if a trading desk's activities satisfy the statutory requirement that underwriting or market making-related activity, as applicable, be designed not to exceed RENTD. Specifically, the proposal would have established a presumption, available to banking entities both with and without significant trading assets and liabilities, that trading within internally set limits satisfies the requirement that permitted activities must be designed not to exceed RENTD.[371] In addition, the agencies also proposed to tailor the exemption for underwriting and market making-related activities' compliance program requirements to the size, complexity, and type of activity conducted by the banking entity by making those requirements applicable only to banking entities with significant trading assets and liabilities.[372]

b. Proposed Presumption of Compliance With the Statutory RENTD Requirement

As described above, the statutory exemptions for underwriting and market making-related activities in section 13(d)(1)(B) of the BHC Act requires that such activities be designed not to exceed RENTD.[373] Consistent with the statute, for the purposes of the exemption for underwriting activities, section __.4(a)(2)(ii) of the 2013 rule requires that the amount and type of the securities in the trading desk's underwriting position be designed not to exceed RENTD, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security.[374]

Similarly, for the purposes of the exemption for market making-related activities, section __.4(b)(2)(ii) of the 2013 rule requires that the amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, RENTD, based on certain factors and analysis.[375] Specifically, these factors are: (i) The liquidity, maturity, and depth of the market for the relevant type of financial instrument(s), and (ii) demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments in which the trading desk makes a market, including through block trades.[376] Under § __.4(b)(2)(iii)(C) of the 2013 rule, a banking entity must account for these considerations when establishing limits for each trading desk.[377]

In the proposal, the agencies recognized that the prescriptive standards for meeting the statutory RENTD requirements in the exemptions for underwriting and market making-related activities were complex, costly, and did not provide bright line conditions under which trading activity

[366] *See* 2013 rule § __.4(b)(2)(iii).

[367] *See* 79 FR at 5615.

[368] 2013 rule § __.4(b)(2). This provision was not intended to expand the scope of licensing or registration requirements under relevant U.S. or foreign law that are applicable to a banking entity engaged in market-making activities, but rather to recognize that compliance with applicable law is an essential indicator that a banking entity is engaged in market-making activities. *See* 79 FR at 5620.

[369] 83 FR at 33435, 33459.

[370] 83 FR at 33445–46.

[371] Proposed rules § __.4(a)(8) and § __.4(b)(6).

[372] 83 FR at 33438 and 33459.

[373] 12 U.S.C. 1851(d)(1)(B).

[374] 2013 rule § __.4(a)(2)(ii).

[375] 2013 rule § __.4(b)(2)(ii).

[376] *Id.*

[377] 2013 rule § __.4(b)(2)(iii)(C).

could be classified as permissible underwriting or market making-related activity.[378] Accordingly, the agencies sought comment on a proposal to implement this key statutory factor—in connection with both relevant exemptions—in a manner designed to provide banking entities and the agencies with greater certainty and clarity about what activity constitutes permissible underwriting or market making-related activity pursuant to the applicable exemption.[379]

Instead of the approach taken in the 2013 rule, the agencies proposed to establish the articulation and use of internal limits as a key mechanism for conducting trading activity in accordance with the rule's exemptions for underwriting and market making-related activities.[380] Specifically, the proposal would have provided that the purchase or sale of a financial instrument by a banking entity would be presumed to be designed not to exceed RENTD if the banking entity establishes internal limits for each trading desk, subject to certain conditions, and implements, maintains, and enforces those limits, such that the risk of the financial instruments held by the trading desk does not exceed such limits.[381] As stated in the proposal, the agencies believe that this approach would provide banking entities with more flexibility and certainty in conducting permissible underwriting and market making-related activities.[382]

Under the proposal, all banking entities, regardless of their volume of trading assets and liabilities, would have been able to voluntarily avail themselves of the presumption of compliance with the RENTD requirement by establishing and complying with these internal limits. With respect to the underwriting exemption, the proposal would have provided that a banking entity would establish internal limits for each trading desk that are designed not to exceed RENTD, based on the nature and amount of the trading desk's underwriting activities, on the:

(1) Amount, types, and risk of its underwriting position;

(2) Level of exposures to relevant risk factors arising from its underwriting position; and

(3) Period of time a security may be held.[383]

With respect to the exemption for market making-related activities, the proposal would have provided that all banking entities, regardless of their volume of trading assets and liabilities, would be able to voluntarily avail themselves of the presumption of compliance with the RENTD requirement by establishing and complying with internal limits. Specifically, the proposal would have provided that a banking entity would establish internal limits for each trading desk that are designed not to exceed RENTD, based on the nature and amount of the trading desk's market making-related activities, on the:

(1) Amount, types, and risks of its market-maker positions;

(2) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(3) Level of exposures to relevant risk factors arising from its financial exposure; and

(4) Period of time a financial instrument may be held.[384]

In the case of both exemptions, the proposal provided that banking entities utilizing the applicable presumption of compliance with the RENTD requirement would have been required to maintain internal policies and procedures for setting and reviewing desk-level risk limits.[385] The proposed approach would not have required that a banking entity's limits be based on any specific or mandated analysis, as required with respect to RENTD analysis under the 2013 rule. Rather, a banking entity would have established the limits according to its own internal analyses and processes around conducting its underwriting activities and market making-related activities in accordance with section 13(d)(1)(B).[386] In addition, the proposal would have required, for both the exemption for underwriting and market making-related activities, a banking entity to promptly report to the appropriate agency when a trading desk exceeds or increases its internal limits.[387]

The proposal also provided that internal limits established by a banking entity for the presumption of compliance with the statutory RENTD requirement under both the exemption for underwriting and market making-related activities would have been subject to review and oversight by the appropriate agency on an ongoing basis. Any review of such limits would have assessed whether or not those limits are established based on the statutory standard—*i.e.,* the trading desk's RENTD, based on the nature and amount of the trading desk's underwriting or market making-related activities.[388]

Finally, under the proposal, the presumption of compliance with the statutory RENTD requirement for permissible underwriting and market making-related activities could have been rebutted by the appropriate agency if the agency determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the trading desk's RENTD on an ongoing basis. The agency would have provided notice of any such determination to the banking entity in writing.[389]

The agencies requested comment on the proposed addition of a presumption that conducting underwriting or market making-related activities within internally set limits satisfies the requirement that permitted such activities be designed not to exceed RENTD.

[378] *See* 83 FR at 33455, 33459.

[379] *Id.*

[380] As stated in the proposal, as a consequence of the changes to focus on limits, many of the requirements of the 2013 rule relating to limits associated with the exemptions for underwriting and market making-related activities would be incorporated into this requirement and modified or removed as appropriate in the proposal.

[381] *See* proposed rule § ▮▮.4(a)(8); proposed rule § ▮▮.4(b)(6).

[382] 83 FR at 33438.

[383] Proposed rule § ▮▮.4(a)(8)(i).

[384] Proposed rule § ▮▮.4(6)(i)(B).

[385] *See* 83 FR at 33456, 33460. Under the proposal, banking entities with significant trading assets and liabilities would have continued to be required to establish internal limits for each trading desk as part of the underwriting compliance program requirement in § ▮▮.4(a)(2)(iii)(B), the elements of which would cross-reference directly to the requirement in proposed § ▮▮.4(a)(8)(i). Similarly, banking entities with significant trading assets and liabilities would have continued to be required to establish internal limits for each trading desk as part of the compliance program requirement for market making-related activity in § ▮▮.4(b)(2)(iii)(C), the elements of which would cross-reference directly to the requirement in proposed § ▮▮.4(b)(6)(i). Banking entities without significant trading assets and liabilities would have no longer been required to establish a compliance program that is specific for the purposes of complying with the either exemption, but would need to establish, implement, maintain and enforce internal limits if they chose to utilize the proposed presumption of compliance with respect to the statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act.

[386] *See* 83 FR at 33456, 34460. In the proposal, the agencies indicated that they expected that the risk and position limits metric that is required for certain banking entities under the 2013 rule (and would continue to be required under the Appendix to the proposal) would help banking entities and the agencies to manage and monitor the underwriting and market making-related activities of banking entities subject to the metrics reporting and recordkeeping requirements of the Appendix.

[387] Proposed rule § ▮▮.4(a)(8)(iii); proposed rule § ▮▮.4(b)(6)(iii).

[388] *See* 83 FR at 33456.

[389] *See* proposed rule § ▮▮.4(a)(8)(iv); proposed rule § ▮▮.4(b)(6)(iv).

c. Commenters' Views

General Approach of a Presumption of Compliance With the Statutory RENTD Requirement

As discussed above, the agencies proposed to establish the articulation and use of internal limits as a key mechanism for conducting trading activity in accordance with the rule's exemptions for underwriting and market making-related activities.[390] A number of commenters expressed support for the general approach of a presumption of compliance to satisfy the RENTD standard.[391] Claiming that the 2013 rule has chilled market making-related activities and is complex and costly and does not provide bright line conditions under which trading can clearly be classified as permissible market making-related activities, one commenter asserted that the general approach would significantly improve upon the approach of the 2013 rule.[392]

One commenter supported the proposed approach on the basis that the presumption would allow banking entities to estimate and manage inventory limits in a more holistic manner to allow for greater and more efficient liquidity and pricing for its clients.[393] That commenter argued that, in comparison to the 2013 rule, a presumption will more effectively leverage existing industry practices and reporting requirements related to managing market-making inventory, such as maintaining daily VaR metrics by product and position limits compared to relative levels of client activity.[394] Another suggested that because internally set limits are developed and applied by each banking entity in light of capital requirements and risk management it would be reasonable to provide a presumption of compliance tied to internally set limits.[395] Finally, one commenter said that the approach would provide a more efficient use of compliance resources and allow banking entities to tailor compliance requirements to its specific underwriting and market making-related activities.[396]

Several commenters, however, expressed concerns about the creation of a presumption of compliance to satisfy the statutory RENTD standard.[397] For example, commenters argued that the proposed presumption is not consistent with the statute,[398] with one commenter claiming that the statutory requirement was intended to constrain bank activities, not bank risks.[399] Commenters expressed concerns that the proposed presumption of compliance is too deferential to banking entities [400] and would reward aggressive banking entities that set their risk limits too high.[401] One commenter argued that the limits would not constrain proprietary trading because the proposed presumption of compliance with RENTD allows banking entities to raise their limits and does not distinguish between permissible and impermissible proprietary trades within risk limits.[402] Another commenter disagreed with a presumption of compliance for underwriting activity, asserting that this approach would undermine well-established principles of safety and soundness, particularly given what the commenter referred to as a general lack of scrutiny over bank-developed risk limits.[403]

Required Analysis for Establishing Risk Limits

As discussed above, the agencies recognized in the proposal that the prescriptive standards in the 2013 rule for meeting the RENTD requirements were complex, costly, and did not provide bright line conditions under which trading can clearly be classified as permissible proprietary trading.[404] As a result, the proposal would not have required that a banking entity's limits be based on any specific or mandated analysis, as was required under the 2013 rule. Rather, under the presumption of compliance with the RENTD requirement in the proposal, a banking entity would have established limits according to its own internal analyses and processes around conducting its underwriting and market making-related activities in accordance with section 13(d)(1)(B) of the BHC Act.[405] Several commenters provided their views on this element of the proposal.

Two commenters supported the agencies' contention in the proposal that the prescriptive standards in the 2013 rule were complex, costly, and did not provide bright line conditions under which trading can clearly be classified as permissible proprietary trading.[406] Some commenters said that removing certain conditions, such as the demonstrable analysis of historical customer demand in § __.4(b)(2)(ii)(B) of the 2013 rule, would increase flexibility and provide certainty for banking entities to engage in market making-related activities since current or reasonably forecasted market demand may be different than historical data may suggest.[407]

Several commenters, however, expressed concerns about the proposed removal of the demonstrable analysis requirement. Some commenters argued that the removal of this requirement will make it harder to for the agencies to rebut the presumption or determine when banking entities have not properly set their RENTD limits.[408] One commenter argued that by not requiring a demonstrable analysis, the proposed rule will allow banking entities to engage in trading activities only superficially tied to customer demand.[409] One commenter expressed a belief that the demonstrable analysis cannot be effectively replaced by other metrics in the proposal, such as the risk and position limits and usage metric in the Appendix because this metric does not provide information on customer demand relative to trading inventories.[410]

To increase flexibility and certainty for banking entities engaged in permitted activities, several of the commenters that supported the general approach of the presumption of compliance with the RENTD requirement requested that this proposed requirement be modified in certain ways. One commenter suggested that the presumption should be available to trading desks that establish internal limits appropriate for their risk appetite, risk capacity, and business strategy and hold themselves out as a

[390] *See* proposed rule § __.4(a)(8); proposed rule § __.4(b)(6).

[391] *See, e.g.,* Credit Suisse; SIFMA; State Street; Real Estate Associations; and BOK.

[392] *See* SIFMA.

[393] *See* State Street.

[394] *Id.*

[395] *See* JBA.

[396] *See* ABA.

[397] *See, e.g.,* Merkley; AFR; Bean; Better Markets; Center for American Progress (CAP); Public Citizen; Volcker Alliance; and Data Boiler.

[398] *See, e.g.,* Bean; Better Markets; CAP; and Public Citizen.

[399] *See* AFR.

[400] *See, e.g.,* AFR; Bean; CAP; Public Citizen; Volcker Alliance; and Data Boiler.

[401] *See, e.g.,* Bean and Volcker Alliance.

[402] *See* Better Markets.

[403] *See* NAFCU.

[404] *See* 83 FR 33459.

[405] *See* 83 FR at 33460. In the proposal, the agencies noted that they expect that the risk and position limits metric that is already required for certain banking entities under the 2013 rule (and would continue to be required under the Appendix to the proposal) would help banking entities and the agencies to manage and monitor the market making-related activities of banking entities subject to the metrics reporting and recordkeeping requirements of the Appendix.

[406] *See, e.g.,* Capital One et al. and SIFMA.

[407] *See* FSF; State Street and SIFMA.

[408] *See* Merkley; Volcker Alliance; and Data Boiler.

[409] *See* Better Markets.

[410] *See* AFR.

market maker.[411] A commenter requested that the agencies revise the presumption to make it available to a banking entity that sets, in a manner agreed to with its onsite prudential examiner and consistent with the intent and purposes of section 13 of the BHC, internal RENTD limits based on factors relevant to the reasonable near-term demand of clients, customers and counterparties, which are calibrated with the intention of not exceeding RENTD.[412] One commenter suggested that, instead of adhering to the more prescriptive aspects of the proposed RENTD presumption, the trading desks of moderate and limited trading assets and liabilities banking entities should be given discretion to adopt internal risk limits appropriate to the activities of the desk subject to other existing bank regulations, supervisory review, and oversight by the appropriate agency and still be able to utilize the presumption of compliance.[413]

Some commenters requested that the agencies clarify aspects of the proposal's RENTD presumption. Commenters asked the agencies to clarify that supervisors and examiners will not impose a one-size fits all approach given the differences in business models among banking entities.[414] While opposed to the general approach of a presumption of compliance with the statutory RENTD requirement, one commenter suggested that, if the agencies adopt the presumption of compliance, additional guidance should be given to banking entities regarding the factors to consider when setting the limits required to establish the presumption of compliance, as the factors in the proposal were too broad and malleable.[415] Another commenter suggested that the agencies clarify that the presumption of compliance should include activity-based limits as a part of its risk-limit structure, such as financial instrument holding periods, notional size and inventory turnover, because activity-based limits are reflective of client demand and an appropriate statutory substitute compared to risk-based limits, which can be hedged.[416]

Specific to the underwriting exemption, one commenter asserted that underwriting activity can be sporadic due to client demand or market factors, which may result in low limit utilization and a rebuttal of the presumption of compliance even when the underwriting position itself is identifiable as part of a primary or follow-on offering of securities.[417] The commenter suggested that the agencies consider corporate actions, such as a debt offering, as an appropriate identifier of permissible underwriting.[418] Another commenter suggested that the agencies permit banking entities to set limits based on the absolute value of profits and losses in the case of an underwriting desk.[419]

Prompt Notifications

As discussed above, the proposal would have required a banking entity to promptly report to the appropriate agency when a trading desk exceeds or increases the internal limits it sets to avail itself of the RENTD presumption with respect to the exemptions for underwriting and market making-related activities.[420] With two exceptions,[421] commenters strongly opposed the proposal's requirement that banking entities promptly report limit breaches.[422] For example, many of these commenters stated that the notifications would be impractical and burdensome to banking entities [423] and would not enhance the oversight capabilities of the agencies because the information is already otherwise available through ordinary supervisory processes,[424] including the internal limits and usage metric.[425] Two commenters asserted that the notices would provide little insight into how risk is managed.[426]

Some commenters expressed concern that complying with the requirement would be particularly challenging for banking entities with parents that are FBOs because these banking entities lack on-site examiners to receive notifications.[427] A few commenters claimed that the prompt notification requirement provides incentives for banking entities to set their limits so high that they have fewer breaches and changes to limits.[428] Commenters also noted that, when risk limits are appropriately calibrated, breaches are not uncommon, and notifying the agencies of each breach could overwhelm the agencies.[429] Another commenter argued that the prompt notification may chill traders' willingness to request changes to limits where it would otherwise be appropriate to accommodate legitimate customer demand.[430]

As an alternative to the prompt notification requirement, many commenters suggested that the agencies require banking entities to make detailed records of limit changes and breaches.[431] Other commenters suggested that the agencies rely on existing supervisory processes to monitor limit breaches and increases,[432] including the internal limits and usage metric.[433]

Rebutting the Presumption

As discussed above, under the proposal, the RENTD presumption could have been rebutted by the appropriate agency if the agency determined, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based

[411] *See* JBA.

[412] *See* SIFMA (recommended that such factors might include, for example, anticipated market volatility and current client inquiries and other indications of client interest, among many others); FSF.

[413] *See* Capital One et al.

[414] *See* CCMR and JBA (In particular, this commenter argued that the agencies should not compare banking entities as it would be an impediment to banking entities that are not the most conservative in its internal risk controls).

[415] *See* Better Markets.

[416] *See* BB&T.

[417] *Id.*

[418] *Id.*

[419] *See* JBA.

[420] *See* proposed rule § ▮▮.4(a)(8)(iii); proposed rule § ▮▮.4(b)(6)(iii).

[421] *See, e.g.,* CFA at 7 (stating that, some small and mid-sized institutions may not have strong internal controls and may be susceptible to the activities of a rogue trader, so the prompt notice requirements allow regulators to impose stricter controls if necessary); Data Boiler at 36 (representing that the prompt reporting requirement would decrease opportunities for evasion of the rule's requirements).

[422] *See, e.g.,* CCMC; BOK; ISDA; Real Estate Associations; Goldman Sachs; GFMA; CREFC; ABA; SIFMA; IIB; BB&T; JBA; FSF; Credit Suisse; and Capital One et al.

[423] *See, e.g.,* CCMR; Credit Suisse; GFMA; FSF; and JBA.

[424] *See, e.g.,* Credit Suisse; ABA; GFMA; IIB; BOK; and SIFMA.

[425] *See, e.g.,* FSF; JBA; ABA; Goldman Sachs; CREFC; and CCMC.

[426] *See, e.g.,* BOK (stating that limit excesses do not, of themselves, show that an institution has changed it strategy or risk tolerance and that reporting by financial institutions might detract from a focus on risk management and shift to a ''number of times exceeded'' view which provides very little insight into how risk is managed); MBA (stating that prompt reporting would encourage the agencies to view events in isolation without consideration to facts and circumstances and that it would be more appropriate to review limit-events in the ordinary course of established supervisory process).

[427] *See, e.g.,* JBA (stating that it would be operationally difficult and costly for foreign headquarters to collect and report data to US regulators); IIB (stating that foreign trading desks would not have on-site examiners to receive reports and that the requirement could intrude into local supervisory matters).

[428] *See, e.g.,* Better Markets; Capital One et al.; and State Street.

[429] *See, e.g.,* GFMA and BOK (stating that limits that are never exceeded ''may not be very useful limits.'').

[430] *See* CCMC.

[431] *See, e.g.,* CCMR and BB&T.

[432] *See, e.g.,* FSF; GFMA; and Real Estate Associations.

[433] *See, e.g.,* FSF; JBA; and ABA.

on the trading desk's RENTD on an ongoing basis.[434]

A few commenters discussed the rebuttal process. For example, one commenter requested that the agencies specify the procedures for an agency to rebut the presumption of compliance.[435] Another commenter recommended that the agencies adopt a consistent procedure for challenging the presumptions in the rule.[436] Another commenter stated that the proposal would only allow the agencies to challenge the risk limit approval and exception process, not the nexus between RENTD and the limits themselves.[437]

d. Final Presumption of Compliance With the Statutory RENTD Requirement

The agencies are adopting the presumption of compliance with the RENTD requirement for both the exemptions for underwriting and market making-related activities largely as proposed, but with modifications intended to be responsive to commenters' concerns.[438]

The agencies are mindful of the concerns raised by commenters regarding the general approach of relying on a banking entity's internal limits to satisfy the statutory RENTD requirement.[439] With respect to the comments described above that the presumption would not be consistent with the statute, the agencies note that the statute permits underwriting and market making-related activities to the extent that such activities are designed not to exceed RENTD. Accordingly, under the final rule the presumption will be available to each trading desk that establishes, implements, maintains, and enforces internal limits that are designed not to exceed RENTD.[440] In addition, with respect to the commenter who expressed concern that the presumption would undermine safety and soundness due to a perceived lack of general scrutiny over banking entity-developed limits, the agencies note that these internal limits will be subject to supervisory review and oversight, which constrains banking entities' ability to set their limits too high. Further, the agencies may review such limits to assess whether or not those limits are consistent with the statutory RENTD standard. This allows the supervisors and examiners to look to the articulation and use of limits to distinguish between permissible and impermissible proprietary trading. The agencies believe that the presumption of compliance, along with the other requirements of the final rule's exemptions for underwriting and market making-related activities, create a framework that will allow banking entities and the agencies to determine whether a trading activity has been designed not to exceed RENTD.

Further, the agencies are concerned that compliance with the 2013 rule's exemptions for underwriting and market making-related activities may be unnecessarily complex and costly to achieve the intended goal of compliance with these exemptions. For example, as noted in the proposal, a number of banking entities have indicated that even after conducting a number of complex and intensive analyses to meet the ''demonstrable analysis'' requirements for the exemption for market making-related activities, they still may be unable to gain comfort that their bona fide market making-related activity meets the factors.[441] Further, the absence of clear, bright-line standards for assessing compliance with the statutory RENTD standard may be unnecessarily constraining underwriting and market making, two critical functions to the health and well-being of financial markets in the United States.

The agencies note commenters' concerns regarding the removal of ''demonstrable analysis'' requirement will make it harder for agencies to rebut the presumption of compliance with the RENTD requirement or determine when banking entities have not properly set their RENTD limits. The agencies believe, however, that requiring a banking entity's internal limits to be based on RENTD as a requirement for utilizing the presumption of compliance should help to simplify compliance with, and oversight of, that statutory standard by placing the focus on how those limits are established, maintained, implemented, and enforced.

Accordingly, under the rule, a banking entity will be presumed to meet the RENTD requirements in § ▮▮.4 (a)(2)(ii)(A) or § ▮▮.4(b)(2)(ii) with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the limits for the relevant trading desk as described in the final rule.[442] With respect to underwriting activities, the presumption will be available to each trading desk that establishes, implements, maintains, and enforces internal limits that are designed not to exceed RENTD, based on the nature and amount of the trading desk's underwriting activities, on the:

(1) Amount, types, and risk of its underwriting position;

(2) Level of exposures to relevant risk factors arising from its underwriting position; and

(3) Period of time a security may be held.[443]

With respect to market making-related activities, the presumption will be available to each trading desk that establishes, implements, maintains, and enforces risk and position limits that are designed not to exceed RENTD, based on the nature and amount of the trading desk's market making-related activities, that address the:

(1) Amount, types, and risks of its market-maker positions;

(2) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(3) Level of exposures to relevant risk factors arising from its financial exposure; and

(4) Period of time a financial instrument may be held.[444]

[434] *See* proposed rule § ▮▮.4(a)(8)(iv); proposed rule § ▮▮.4(b)(6)(iv).

[435] *See* MBA.

[436] *See* IIB.

[437] *See* Better Markets.

[438] In addition to the changes described in this section, the presumption of compliance has been moved into a new paragraph (c) in § ▮▮.4, as opposed to including separate provisions under each of the two relevant exemptions. That change was intended solely for clarity and to avoid any unnecessary duplication in light of the fact that the process for complying with the presumption of compliance is identical for both exemptions. New paragraph (c) does, however, recognize that the limits banking entities will be required to implement, maintain, and enforce will differ as between the exemptions for underwriting and market making-related activities. *See* final rule §§ ▮▮.4(c)(2)(A) and ▮▮.4(c)(2)(B).

[439] As noted above, this includes commenters who argue that such amendments will undermine the operation of the 2013 rule, lead to increased risk taking among banking entities, and conflict with the statutory requirements in section 13(d)(1)(B) of the BHC Act. *See supra* notes 28, 36–41 and accompanying text.

[440] For consistency with the final rule's RENTD requirement, the sub-heading for § ▮▮.4(c)(1) has been changed from ''risk limits'' to ''limits.''

[441] 83 FR at 33459.

[442] *See* final rule, § ▮▮.4(c)(1)(i).

[443] *See* final rule § ▮▮.4(c)(1)(ii)(A). The language in this paragraph of the rule has been modified slightly from the proposal to clarify that such limits should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments. As this language comes directly from the RENTD requirement in § ▮▮.4 (a)(2)(ii)(A), the agencies do not view this as a substantive change. Rather, the agencies believe that it is important to emphasize in the rule text that the limit used to satisfy the presumption of compliance for one type of financial instrument will not necessarily be the same for other types of financial instruments and that the particular characteristics of the relevant market should be taken into account throughout the process of setting these limits.

[444] *See* final rule § ▮▮.4(c)(1)(ii)(B). For the reasons described in connection with the limits required as satisfy the presumption of compliance in connection with the underwriting exemption, the

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Some commenters also noted that the agencies should not take a ''one-size- fits-all'' approach to the limits that must be established to satisfy the presumption of compliance with RENTD on the basis that not all of the proposed limits may be applicable to every type of financial instrument, particularly derivatives.[445] In response to these commenters, the agencies have modified the rule text to clarify that the limits required to be established by a banking entity in order to satisfy the presumption of compliance must address certain items. The agencies recognize that certain of the enumerated items, which are unchanged from the proposal, may be more easily applied for desks that engage in market-making in securities rather than derivatives, and emphasize that section __.4(b), both as currently in effect and as amended, is intended to provide banking entities with the flexibility to determine appropriate limits for market making-related activities that are designed not to exceed RENTD, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments.

With respect to derivatives, certain of the enumerated items may not be effective for designing market making-related activities not to exceed RENTD, which is ultimately the primary purpose of adopting a presumption of compliance based on the establishment and use of internal limits.[446] Under those circumstances, the agencies acknowledge that it may be appropriate for banking entities to 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.[447]

For example, for a desk that engages in market making-related activities only with respect to derivatives (or derivatives and non-financial instruments), the requirement to establish, implement, maintain, and enforce limits designed not to exceed RENTD could be satisfied to the extent the banking entity establishes limits on the market making desk's level of exposures to relevant risk factors arising from its financial exposure and such limits are designed not to exceed RENTD (including derivatives positions related to a request from a client, customer, or counterparty), based on the nature and amount of the trading desk's market making-related activities. Such limits would be consistent with the underlying purpose of the exemption for market making-related activities, which is to implement the restriction on a banking entity's proprietary trading activities while still allowing market makers to provide intermediation and liquidity services necessary to the functioning of our financial markets.

Consistent with the proposal, the limits used to satisfy the presumption of compliance under the final rule will be subject to supervisory review and oversight by the applicable agency on an ongoing basis.[448] Moreover, the final rule provides that the presumption of compliance may be rebutted by the applicable agency if such agency determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not designed not to exceed RENTD.[449] In a modification from the proposed rule, the final rule contains additional language that specifies that the agencies will take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments when determining whether to rebut the presumption of compliance. This change is intended to provide additional clarity regarding the factors the agencies will consider when making this determination. In response to commenters' concerns about the rebuttal process, the final rule specifies that any such rebuttal of the presumption must be made in accordance with the notice and response procedures in subpart D of the rule.[450]

The agencies are, however, persuaded by the arguments raised by some commenters with respect to the proposed requirement that a banking entity promptly report to the appropriate agency when a trading desk exceeds or increases its internal limits to avail itself of the RENTD presumption with respect to the exemptions for underwriting and market making-related activity.[451] The agencies recognize that limits that are set so high as to never be breached are not necessarily meaningful limits. Thus, breaches of appropriately set limits may occur with a frequency that does not justify notifying the agencies for every single breach. The agencies recognize that the burdens associated with preparing and reporting such information may not be justified in light of the potential benefits of such requirement.

Accordingly, the final rule instead requires banking entities to maintain and make available to the applicable agency, upon request, records regarding (1) any limit that is exceeded and (2) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the agency.[452] Moreover, when a limit is breached or increased, the presumption of compliance with RENTD will continue to be available so long as the banking entity: (1) Takes action as promptly as possible after a breach to bring the trading desk into compliance; and

(2) follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval.[453] The agencies believe that this requirement will provide the agencies with sufficient information to determine whether a banking entity's existing limits are appropriately calibrated to comply with the RENTD requirement for that particular financial instrument.[454]

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language in this paragraph has been modified slightly from the proposal to clarify that such limits must take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments. *See id.*

[445] *See e.g.,* FSF, SIFMA.

[446] As previously noted, the final rule also replaces the existing definition of ''market maker-inventory'' with a definition of ''market-maker positions.'' This change was intended to reflect the fact that requiring banking entities seeking to rely on the presumption of compliance with the RENTD requirement to have limits on market maker-inventory is generally unworkable in the context of derivatives. *See infra* note 458 and accompanying text.

[447] The agencies note that this discussion does not encompass or impact the CFTC's or SEC's treatment of market-making in derivatives for purposes other than section 13 of the BHC Act and the rule.

[448] *See* final rule § __.4(c)(2). The supervisory review provision in the proposed rule stated that ''any review of such limits will include assessment of whether the limits are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.'' Sections __ .4(c)(1)(i)–(ii) of the final rule clearly stipulate that such limits must be designed not to exceed the reasonably expected near term demand of clients, customers, or counterparties. To avoid redundancy, this language has been omitted from § __.4(c)(2) in the final rule.

[449] *See* final rule § __.4(c)(4).

[450] *See infra* notes 655–58 and accompanying text (discussion of the notice and response procedures in § __.20(i)).

[451] *See* proposed rule §§ __.4(a)(8)(iii) and __.4(b)(6)(iii). *See also supra* note 387 and accompanying text.

[452] *See* final rule § __.4(c)(3)(i).

[453] *See* final rule § __.4(c)(3)(i).

[454] The agencies note that the final rule requires that banking entities with significant trading assets

e. Additional Changes to the Final Rule's Underwriting and Market Making-Related Activities Exemptions

In addition to the changes described above, the final rule's exemptions for underwriting and market making-related activities contain several other conforming and clarifying changes. Consistent with the proposed rule, the structure of § __.4(a)(ii) in the final rule has been modified to clarify that the applicable paragraph contains two separate and distinct requirements.[455] In addition, several definitions used in the final rule's exemptions for underwriting and market making-related activities have also been modified. Specifically, the phrase ''paragraph (b)'' has been replaced with ''this section'' in the definition of ''underwriting position'' because the defined term is used in several places.[456] The definition of ''financial exposure'' has been similarly modified.[457] Finally, the final rule, however, replaces the existing definition of ''market maker-inventory'' with a definition for ''market-maker positions'' to correspond with the language in § __.4(c)(ii)(B)(1), which is the only place such definition is used.[458]

f. Compliance Program and Other Requirements for Underwriting and Market Making-Related Activities

2013 Rule Compliance Program Requirements

The underwriting exemption in § __.4(a) of the 2013 rule requires a banking entity to establish, implement, maintain, and enforce an internal compliance program, as required by subpart D, that is reasonably designed to ensure compliance with the requirements of the exemption. Such compliance program is required to include reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing: (i) The products, instruments, or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities; (ii) certain limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties; [459] (iii) internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and (iv) authorization procedures, including escalation procedures that require review and approval of any trade that would exceed one or more of a trading desk's limits, demonstrable analysis of the basis for any temporary or permanent increase to one or more of a trading desk's limits, and independent review (*i.e.,* by risk managers and compliance officers at the appropriate level independent of the trading desk) of such demonstrable analysis and approval.

The exemption for market making-related activities in the 2013 rule contains similar requirements. Specifically, § __.4(b) of the 2013 rule requires that a banking entity establish, implement, maintain, and enforce an internal compliance program, as required by subpart D, that is reasonably designed to ensure compliance with the requirements of the exemption. Such a compliance program is required to include reasonably designed written policies and procedures, internal controls, analysis, and independent testing identifying and addressing: (i) The financial instruments each trading desk stands ready to purchase and sell in accordance with the exemption for market making-related activities; (ii) the actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C), and the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective; (iii) the limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, including the reasonably expected near term demands of clients, customers, or counterparties; [460] (iv) internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and (v) authorization procedures, including escalation procedures that require review and approval of any trade that would exceed one or more of a trading desk's limits, demonstrable analysis of the basis for any temporary or permanent increase to one or more of a trading desk's limits, and independent review (*i.e.,* by risk managers and compliance officers at the appropriate level independent of the trading desk) of such demonstrable analysis and approval.

Proposed Compliance Program Requirement

Feedback from market participants and agency oversight have indicated that the compliance program requirements of the existing exemptions for underwriting and market making-related activities may be unduly complex and burdensome for banking entities with smaller and less active trading activities. In the proposed rule, the agencies proposed a tiered approach to such compliance program requirements, to make these requirements commensurate with the size, scope, and complexity of the relevant banking entity's trading activities and business structure. Under the proposed rule, a banking entity with significant trading assets and liabilities would continue to be required to establish, implement, maintain, and enforce a comprehensive internal compliance program as a condition for relying on the exemptions for underwriting and market making-related activities. However, the agencies proposed to eliminate such compliance program requirements for banking entities that have moderate or limited trading assets and liabilities.[461]

Comments on the Proposed Compliance Program Requirement

Some commenters did not support the removal of the underwriting or market making-specific compliance program

and liabilities must record and report the quantitative measurements contained in the Appendix to the final rule. *See infra* Subpart E—Metrics: Appendix to Part [•]—Reporting and Recordkeeping Requirements. The agencies believe that the risk and position limits metric will also help banking entities and the agencies monitor the underwriting and market making-related activities of banking entities with significant trading assets and liabilities.

[455] Unlike the 2013 rule, § __.4(a)(ii) in the final rule contains subparagraphs (A) and (B).

[456] *See* § __.4(a)(6).

[457] *See* § __.4(b)(4).

[458] *See* § __.4(c)(ii)(B)(1). With respect to the exemption for market making-related activities, the rebuttable presumption of compliance for the RENTD requirement in the final rule requires, among other things, that a trading desk establish, implement, and enforce limits on the amounts, types, and risks of its market-maker positions.

[459] These factors include the: (1) Amount, types, and risk of its underwriting position; (2) level of exposures to relevant risk factors arising from its underwriting position; and (3) period of time a security may be held.

[460] Specifically, such limits include the: (1) Amount, types, and risks of its market-maker inventory; (2) amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes; (3) the level of exposures to relevant risk factors arising from its financial exposure; and (4) period of time a financial instrument may be held.

[461] Under the 2013 rule, the compliance program requirement in § __.4(a)(2)(iii) is part of the compliance program required by subpart D but is specifically used for purposes of complying with the exemption for underwriting activity.

requirements for banking entities with limited and moderate trading assets and liabilities under the proposal. For example, one commenter urged the agencies to require all banking entities to establish, implement, maintain, and enforce such compliance program, independent of any presumption of compliance.[462] This commenter indicated that there are ''exceedingly low incremental costs'' associated with most elements of the RENTD compliance and controls framework for the exemptions for underwriting and market making-related activities, even for those banking entities with limited or moderate trading assets and liabilities.[463] In the commenter's view, minimal incremental costs support the retention of such requirements, which are further justified by the increased stability of financial institutions and financial markets as a result of the 2013 rule.[464]

Further, that same commenter asserted that the compliance requirements under the 2013 rule permit too much discretion for banking entities to implement policies, procedures, and controls, noting that judgments on the effectiveness of implemented controls depend on the methodologies used by banking entities' testing functions, and argued that the agencies should consider additional capital and activities-based requirements specifically tied to the reported inventory of trading assets, taking into account the total size of those trading assets, the overall capital position of the financial institution, and the average holding period or aging of trading assets, which may indicate that inventories are unrelated to underwriting and market making activities.[465] Similarly, another commenter indicated that a tiered compliance approach would not be appropriate because it considered the proposed categorization of entities in terms of trading assets and liabilities to be flawed.[466]

Other commenters supported the revisions under the proposed rule to apply the market making-related activities' compliance program requirements only to those banking entities with significant trading assets and liabilities. For example, one commenter expressed concern that the market making-related activities' compliance program requirements under the 2013 rule have contributed to decreased market making activities with, and increased costs for, banking entities' commercial end-user counterparties.[467] This commenter indicated that applying the market making-related activities' compliance program requirements only to banking entities with significant trading assets and liabilities would allow banking entities to develop more efficient compliance and liquidity risk management programs, which would ultimately reduce transaction costs for commercial end users.[468]

Another commenter expressed the view that the proposed approach of applying the compliance program requirements under the exemptions for underwriting and market making-related activities only to those banking entities with significant trading assets and liabilities was an appropriate means of reducing the regulatory burdens on banks with limited or moderate trading and underwriting exposures.[469] That commenter noted that such approach would continue to allow for the appropriate monitoring of these activities to ensure compliance with the provisions of the 2013 rule.[470]

Final Compliance Program Requirement

The agencies believe that the compliance program requirements that apply specifically to the exemptions for underwriting and market making-related activities play an important role in facilitating and monitoring a banking entity's compliance with the requirements of those exemptions. However, the agencies also believe that those requirements can be appropriately tailored to the nature of the underwriting and market making activities conducted by each banking entity. It also is important to recognize that the removal of such compliance program requirements for banking entities that do not have significant trading assets and liabilities would not relieve those banking entities of the obligation to comply with the other requirements of the exemptions for underwriting and market making-related activities, including RENTD requirements, under the final rule.

Accordingly, and after consideration of the comments, the agencies continue to believe that removing the § ■■.4 compliance program requirements for banking entities that do not have significant trading assets and liabilities as a condition to engaging in permitted underwriting and market making-related activities should provide these banking entities with additional flexibility to tailor their compliance programs in a way that takes into account the risk profile and relevant trading activities of each particular trading desk.

The agencies recognize that banking entities that do not have significant trading assets and liabilities may incur costs to establish, implement, maintain, and enforce the compliance program requirements applicable to permitted underwriting activities under the 2013 rule. As the trading activities of banking entities that do not have significant trading activities comprise approximately seven percent of the total U.S. trading activity subject to the Volcker Rule, the agencies believe the costs of the compliance program requirement would be disproportionate to the banking entity's trading activity and the risk posed to U.S. financial stability. Accordingly, eliminating the § ■■.4 compliance program requirements for permitted underwriting and market making-related activities conducted by banking entities that do not have significant trading assets and liabilities may reduce compliance costs without materially impacting conformance with the objectives set forth in section 13 of the BHC Act. Applying these specific compliance requirements only to banking entities with significant trading assets and liabilities also is consistent with the modifications to the general compliance program requirements for these banking entities under § ■■.20 of the final rule, as discussed below.

Accordingly, § ■■.4(a)(2)(iii) of the final rule will require banking entities with significant trading assets and liabilities, as a condition to complying with the underwriting exemption, to establish and implement, maintain, and enforce an internal compliance program required by subpart D that is reasonably designed to ensure the banking entity's compliance with the requirements of the exemption, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with § ■■.4(a)(2)(ii)(A);[471]

[462] *See* Better Markets.

[463] *Id.*

[464] *Id.*

[465] *Id.*

[466] *See* Data Boiler.

[467] *See* Coalition of Derivatives End Users.

[468] *Id.*

[469] *See* CFA.

[470] *Id.*

[471] Final rule § ■■.4(a)(2)(ii)(A) requires that the amount and type of the securities in the trading desk's underwriting position are designed not to exceed RENTD, taking into account the liquidity, maturity, and depth of the market for the relevant type of security; and (B) that reasonable efforts are made to sell or otherwise reduce the underwriting

(C) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

With respect to the exemption for market making-related activities, § __.4(a)(b)(iii) of the final rule will require banking entities with significant trading assets and liabilities to establish and implement, maintain, and enforce an internal compliance program required by subpart D that is reasonably designed to ensure the banking entity's compliance with the requirements of the exemption, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with § __.4(b)(2)(i);[472]

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under § __.4 (b)(2)(iii)(C); the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, in accordance with § __.4(b)(2)(ii);[473]

(D) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(E) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

The agencies are clarifying in the final rule that the authorization procedures for banking entities with significant trading assets and liabilities of proposed § __.4(a)(2)(iii)(D) and § __.4(b)(2)(iii)(E) are to be in writing pursuant to § __.4(a)(2)(iii)(C) and § __.4(b)(2)(iii)(D). Requiring that these authorization procedures are written provides a basis for which banking entities and supervisors can review for compliance with the underwriting and market making exemption compliance requirements.

Sections __.4(a)(2)(iii) (which sets forth the compliance program requirements for the underwriting exemption) and § __.4(b)(2)(iii) (which sets forth the compliance program requirements for the exemptions for market making-related activities) further provide that a banking entity with significant trading assets and liabilities may satisfy the requirements pertaining to limits and written authorization procedures by complying with the requirements pursuant to the presumption of compliance with the statutory RENTD requirement in § __.4(c).[474] As such, § __.4(c)(1) provides for a rebuttable presumption that a banking entity's purchase or sale of a financial instrument complies with the RENTD requirements in § __.4(a)(2)(ii)(A) and § __.4(b)(2)(ii) if the relevant trading desk establishes, implements, maintains, and enforces internal limits that are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant type of security. In taking this approach, the agencies recognize that requiring a banking entity to establish separate limits in accordance with the statutory RENTD requirement would be unnecessary and may reduce the benefit of relying on internal limits set pursuant to § __.4(c)(1).

Additionally, in the case of a banking entity with significant trading assets and liabilities, the relevant exemption compliance requirements pertaining to written authorization procedures in § __.4(a)(2)(iii)(C) are not required if the criteria in § __.4(c) are satisfied. Without the requirement to establish limits pursuant to § __.4(a)(iii)(B), such a requirement for written authorization procedures would be unnecessary. Further, because § __.4(c)(3)(ii)(2) contains written authorization procedures, also requiring written authorization procedures in § __.4(a)(2)(iii)(C) would be duplicative.

These revisions clarify that banking entities with significant trading assets and liabilities that establish limits and written authorization procedures pursuant to the rebuttable presumption of compliance do not have to establish a second set of limits and written authorization procedures pursuant to the compliance program requirements of the underwriting or market making exemptions. Regardless of whether a banking entity with significant trading assets and liabilities relies on the presumption of compliance in § __.4(c), every banking entity with significant trading assets and liabilities is required to maintain limits and written authorization procedures for purposes of complying with the exemption for permitted underwriting or market making-related activities under § __.4.

The agencies are removing the proposed rule's requirement for a banking entity with significant trading assets and liabilities that, to the extent that any limit identified pursuant to § __.4(b)(2)(iii)(C) of the proposed rule is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded. Instead, this requirement is being moved to § __.4(c), the rebuttable presumption of compliance for banking entities that establish internal limits pursuant to § __.4(c)(1). Such requirements would be redundant for a banking entity with significant trading assets and liabilities that is required, on an ongoing basis, to ensure that its trading desk's market making activities are designed not to exceed RENTD while also establishing limits designed not to exceed RENTD.[475] In addition, the written authorization procedures[476]

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position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security.

[472] Final rule § __.4(b)(2)(i) requires that the trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments.

[473] Final rule § __.4(b)(2)(ii) requires that the trading desk's market making-related activities are designed not to exceed, on an ongoing basis, RENTD, taking into account the liquidity, maturity, and depth of the market for the relevant type of security.

[474] *See supra* section IV.B.2.d (discussing the requirements in the final rule associated with the presumption of compliance with the statutory RENTD requirement).

[475] *See* final rule § __.4(b)(2)(iii)(C).

[476] *See* final rule § __.4(b)(2)(iii)(D).

require internal compliance processes to handle such limit breaches.

g. Other Comments

Finally, some commenters recommended changes to certain aspects of the existing exemptions for underwriting and market making-related activities in the 2013 rule that were not specifically proposed. For example, one commenter suggested that the agencies eliminate the limitations on treating banking entities with greater than $50 billion in trading assets and liabilities as clients, customers, or counterparties.[477] As stated in the 2013 rule, the agencies believe that removing this limitation could make it difficult to meaningfully distinguish between permitted market making-related activity and impermissible proprietary trading, and allow a trading desk to maintain an outsized inventory and to justify such inventory levels as being tangentially related to expected market-wide demand.[478] The agencies also believe that banking entities engaged in substantial trading activity do not typically act as customers to other market makers.[479] As a result, the agencies have retained the 2013 rule's definition of client, customer, or counterparty. Another commenter suggested broadening the scope of the exemption for underwriting activities to encompass any activity that assists persons or entities in accessing the capital markets or raising capital.[480] The agencies believe the final rule's changes provide additional clarity while maintaining consistency with statutory objectives. Accordingly, after consideration of these comments, the agencies have decided not to make any changes to the exemptions for underwriting or market making-related activities other than those discussed above.

h. Market Making Hedging

As noted in the proposal, during implementation of the 2013 rule, the agencies received a number of inquiries regarding the circumstances under which banking entities could elect to comply with the market making risk management provisions permitted in § ▮▮.4(b) or alternatively the risk-mitigating hedging requirements under § ▮▮.5. These inquiries generally related to whether a trading desk could treat an affiliated trading desk as a client, customer, or counterparty for purposes of the exemption market making-related activities' RENTD requirement; and whether, and under what circumstances, one trading desk could undertake market making risk management activities for one or more other trading desks.[481]

Each trading desk engaging in a transaction with an affiliated trading desk that meets the definition of proprietary trading must rely on an exemption or exclusion in order for the transaction to be permissible. As noted in the proposal, in one example presented to the agencies, one trading desk of a banking entity may make a market in a certain financial instrument (*e.g.,* interest rate swaps), and then transfer some of the risk of that instrument (*e.g.,* foreign exchange (FX) risk) to a second trading desk (*e.g.,* an FX swaps desk) that may or may not separately engage in market making-related activity. In the proposal, the agencies requested comment as to whether, in such a scenario, the desk taking the risk (in the preceding example, the FX swaps desk) and the market making desk (in the preceding example, the interest rate desk) should be permitted to treat each other as a client, customer, or counterparty for purposes of establishing internal limits or RENTD levels under the exemption for market making-related activities.[482]

The agencies also requested comment as to whether each desk should be permitted to treat swaps executed between the desks as permitted market making-related activities of one or both desks if the swap does not cause the relevant desk to exceed its applicable limits and if the swap is entered into and maintained in accordance with the compliance requirements applicable to the desk, without treating the affiliated desk as a client, customer, or counterparty for purposes of establishing or increasing its limits. This approach was intended to maintain appropriate limits on proprietary trading by not permitting an expansion of a trading desk's market making limits based on internal transactions. At the same time, this approach was intended to permit efficient internal risk management strategies within the limits established for each desk.[483]

The agencies also requested comment on the circumstances in which an organizational unit of an affiliate (affiliated unit) of a trading desk engaged in market making-related activities in compliance with § ▮▮.4(b) (market making desk) would be permitted to enter into a transaction with the market making desk in reliance on the market making desk's risk management policies and procedures. In this scenario, to effect such reliance the market making desk would direct the affiliated unit to execute a risk-mitigating transaction on the market making desk's behalf. If the affiliated unit did not independently satisfy the requirements of the exemption for market making-related activities with respect to the transaction, it would be permitted to rely on the exemption for market making-related activities available to the market making desk for the transaction if: (i) The affiliated unit acts in accordance with the market making desk's risk management policies and procedures; and (ii) the resulting risk-mitigating position is attributed to the market making desk's financial exposure (and not the affiliated unit's financial exposure) and is included in the market making desk's daily profit and loss calculation. If the affiliated unit establishes a risk-mitigating position for the market making desk on its own accord (*i.e.,* not at the direction of the market making desk) or if the risk-mitigating position is included in the affiliated unit's financial exposure or daily profit and loss calculation, then the affiliated unit may still be able to comply with the requirements of the risk-mitigating hedging exemption pursuant to § ▮▮.5 for such activity.[484]

The commenters were generally in favor of permitting affiliated trading desks to treat each other as a client, customer, or counterparty for the purposes of establishing risk limits or RENTD levels under the exemption for market making-related activities,[485] particularly for banking entities that service customers in different jurisdictions. One commenter, however, did not support this approach, and expressed that it would be difficult to validate banking entities' RENTD limits if affiliates could be considered as a client, customer, or counterparty.[486]

One commenter argued that affiliated trading desks with different mandates should be able to treat each other as a client, customer, or counterparty as long as each desk stays within its limits, because such an approach would allow banking entities to take an enterprise-wide view of risk management.[487]

Two commenters explained that, to increase efficiencies, certain internationally active banking entities employ a ''hub-and-spoke'' model, where trading desks at local entities

[477] *See* CCMC.

[478] *See* 79 FR 5607.

[479] *See* 79 FR 5606–5607.

[480] *See* ISDA.

[481] 83 FR at 33464.

[482] *Id.*

[483] *Id.*

[484] *Id.*

[485] *See, e.g.,* HSBC; JBA; and IIB.

[486] *See* Data Boiler.

[487] *See* IIB.

(spoke) enter into transactions with major affiliates (hub) that manage the risks of, and source trading positions for, the local entities.[488] One of these commenters expressed that these trading desks have trouble demonstrating they are indeed market making desks without intra-entity and inter-affiliate transactions being treated as transactions with a client, customer, or counterparty.[489] The other commenter expressed that, under the hub-and-spoke model, treating the ''spoke'' trading desk as a client, customer, or counterparty, would allow the hub desk to look through to the customer of the local entity since the hub is acting as the ultimate market maker.[490]

After consideration of comments, the agencies continue to recognize that, under certain circumstances, a trading desk may undertake market making risk management activities for one or more affiliated trading desks [491] and trading desks may rely on the exemption for market making-related activities for its transactions with affiliated trading desks. The agencies, however, are declining to permit banking entities to treat affiliated trading desks as ''clients, customers, or counterparties'' [492] for the purposes of determining a trading desk's RENTD pursuant to § ▮▮.4(b)(2)(ii) of the exemption for market making-related activities.

The agencies believe that, under the exemption for market making-related activities, each trading desk must be able to independently tie its activities to the RENTD of external customers that the trading desk services. Allowing a desk to treat affiliated trading desks as customers for purposes of RENTD would allow the desk to accumulate financial instruments if it has a reason to believe that other internal desks will be interested in acquiring the positions in the near term. Those other desks could then acquire the positions from the first desk at a later time when they have a reasonable expectation of near term demand from external customers. The agencies also believe that generally allowing a desk to treat other internal desks as customers for purposes of RENTD could impede monitoring of market making-related activity and detection of impermissible proprietary trading since a banking entity could aggregate in a single trading desk the RENTD of trading desks that engage in multiple different trading strategies and aggregate a larger volume of trading activities.[493]

With respect to the arguments raised by these commenters that permitting this treatment would facilitate efficient risk management,[494] the agencies believe that the amendments to the risk-mitigating hedging exemption in the final rule [495] and the amendments to the liquidity management exemption in the final rule [496] will provide banking entities with additional flexibility to manage risks more efficiently than the 2013 rule.

Further, the agencies note that while affiliated trading desks may not consider each other clients, customers, or counterparties, transactions between affiliated trading desks may be permitted under the exemption for market making-related activities in certain circumstances that do not require the expansion of a trading desk's market making limits based on internal transactions. Returning to the example from the proposal and described above [497] concerning an interest rate swaps desk transferring some of the risk of a financial instrument to an affiliated FX swaps desk, if the FX swaps desk acts as a market maker in FX swaps, the FX swaps desk may be able to rely on the exemption for market making-related activities for its transactions with the interest rate swaps desk if those transactions are consistent with the requirements of the exemption for market making-related activities, including the FX swaps desk's RENTD.[498] Further, if the FX swaps desk does not independently satisfy the requirements of the exemption for market making-related activities with respect to the transaction, it would be permitted to rely on the exemption for market making-related activities available to the market making desk for the transaction under certain conditions. If the banking entity has significant trading assets and liabilities, the FX swaps desk would be permitted to rely on the exemption for market making-related activities if: (i) The FX swaps desk acts in accordance with the interest rate swaps desk's risk management policies and procedures established in accordance with § ▮▮.4(b)(2)(iii) and (ii) the resulting risk-mitigating position is attributed to the interest rate swaps desk's financial exposure (and not the FX swaps desk's financial exposure) and is included in the interest rate swaps desk's daily profit and loss calculation. If the banking entity does not have significant trading assets and liabilities, the FX swaps desk would be permitted to rely on the exemption for market making-related activities if the resulting risk-mitigating position is attributed to the interest rate swaps desk's financial exposure (and not the FX swaps desk's financial exposure) and is included in the interest rate swaps desk's daily profit and loss calculation. If the FX swaps desk cannot independently satisfy the requirements of the exemption for market making-related activities with respect to its transactions with the interest rate swaps desk, the risk-mitigating hedging exemption would be available, provided the conditions of that exemption are met.

3. Section ▮▮.5: Permitted Risk-Mitigating Hedging Activities

a. Section ▮▮.5 of the 2013 Rule

Section 13(d)(1)(C) of the BHC Act provides an exemption from the prohibition on 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. Section ▮▮.5 of the 2013 rule implements section 13(d)(1)(C).

Section ▮▮.5 of the 2013 rule provides a multi-faceted approach to implementing the hedging exemption to ensure that hedging activity is designed to be risk-reducing and does not mask prohibited proprietary trading. Under the 2013 rule, risk-mitigating hedging activities must comply with certain conditions for those activities to qualify for the exemption. Generally, a banking entity relying on the hedging exemption must have in place an appropriate internal compliance program that meets specific requirements, including the requirement to conduct certain correlation analysis, to support its compliance with the terms of the exemption, and the compensation arrangements of persons performing risk-mitigating hedging activities must be designed not to reward or incentivize

[488] *See* HSBC and JBA.

[489] *See* JBA.

[490] *See* HSBC.

[491] *See* 79 FR at 5594.

[492] § ▮▮.4(b)(3).

[493] *See* 79 FR at 5590.

[494] *See* HSBC; JBA; and IIB.

[495] The agencies are streamlining several aspects of the risk-mitigating hedging exemption for banking entities with and without significant trading assets and liabilities. *See* final rule § ▮▮.5; *See also* section IV.B.3, *infra*.

[496] The agencies have expanded the types of financial instruments eligible for the exclusion to include for exchange forwards and foreign exchange swaps. *See* final rule § ▮▮.3(e); *See also* section IV.B.1.b.i, *supra*.

[497] *See* Part IV.B.2.h, *supra; see also* 83 FR 33463.

[498] The interest rate market making desk can rely on the exemption for market making-related activities for the FX swap it enters into with the FX swaps desk provided the interest rate market making desk enters into the FX swap to hedge its market making-related position and otherwise complies with the requirements of the exemption for market making-related activities.

prohibited proprietary trading.[499] In addition, the hedging activity itself must meet specified conditions. For example, at inception, the hedge must be designed to reduce or otherwise significantly mitigate, and must demonstrably reduce or otherwise significantly mitigate, one or more specific, identifiable risks arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, and the activity must not give rise to any significant new or additional risk that is not itself contemporaneously hedged.[500] Finally, § __.5 establishes certain documentation requirements with respect to the purchase or sale of financial instruments made in reliance of the risk-mitigating exemption under certain circumstances.[501]

b. Proposed Amendments to Section __.5

i. Correlation Analysis for Section __.5(b)(1)(iii)

The agencies proposed to remove the specific requirement to conduct a correlation analysis for risk-mitigating hedging activities.[502] In particular, the agencies proposed to remove the words ''including correlation analysis'' from the requirement that the banking entity seeking to engage in risk-mitigating hedging activities conduct ''analysis, including correlation analysis, and independent testing'' designed to ensure that hedging activities may reasonably be expected to reduce or mitigate the risks being hedged. Thus, the requirement to conduct an analysis would have remained, but the banking entity would have had flexibility to apply a type of analysis that was appropriate to the facts and circumstances of the hedge and the underlying risks targeted.[503]

The agencies noted that they have become aware of practical difficulties with the correlation analysis requirement, which according to banking entities can add delays, costs, and uncertainty to permitted risk-mitigating hedging.[504] The agencies anticipated that removing the correlation analysis requirement would reduce uncertainties in meeting the analysis requirement without significantly impacting the conditions that risk-mitigating hedging activities must meet in order to qualify for the exemption.[505]

The agencies also noted that section 13 of the BHC Act does not specifically require this correlation analysis.[506] Instead, the statute only provides that a hedging position, technique, or strategy is permitted so long as it is ''. . . designed to reduce the specific risks to the banking entity ....'' [507] The 2013 rule added the correlation analysis requirement as a measure intended to ensure compliance with this exemption.

ii. Hedge Demonstrably Reduces or Otherwise Significantly Mitigates Specific Risks for Sections __.5(b)(1)(iii), __.5(b)(2)(ii), and __.5(b)(2)(iv)(B)

The agencies stated in the proposal that the requirements in § __.5(b)(1)(iii), § __.5(b)(2)(ii), and § __.5(b)(2)(iv)(B), that a risk-mitigating hedging activity demonstrably reduces or otherwise significantly mitigates specific risks, is not directly required by section 13(d)(1)(C) of the BHC Act.[508] The statute instead requires that the hedge *be designed* to reduce or otherwise significantly mitigate specific risks.[509] Thus, the agencies proposed to remove the ''demonstrably reduces or otherwise significantly mitigates'' specific risk requirement from § __.5(b)(2)(ii) and § __.5(b)(2)(iv)(B). This change would retain the requirement that the hedging activity be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, while providing banking entities with the flexibility to apply a type of analysis that was appropriate to the facts and circumstances of the hedge and the underlying risks targeted.

The agencies also proposed to remove parallel provisions in § __.5(b)(1)(iii). In particular, the agencies proposed to delete the word ''demonstrably'' from the requirement that ''the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged'' in § __.5(b)(1)(iii). This change would have meant that the banking entity's analysis and testing would have had to show that the hedging may be expected to reduce or mitigate the risks being hedged, but without the specific requirement that such reduction or mitigation be demonstrable. The agencies also proposed to delete the requirement in § __.5(b)(1)(iii) that ''such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged'' because this requirement was not necessary if the ''correlation analysis'' and ''demonstrable'' requirements were deleted.

The agencies noted that, in practice, it appears that the requirement to show that hedging activity demonstrably reduces or otherwise significantly mitigates a specific, identifiable risk that develops over time can be complex and could potentially reduce bona fide risk-mitigating hedging activity. For example, in some circumstances it would be very difficult, if not impossible, for a banking entity to comply with the continuous requirement to demonstrably reduce or significantly mitigate the identifiable risks, and therefore the firm would not enter into what would otherwise be effective hedges of foreseeable risks.[510]

iii. Reduced Compliance Requirements for Banking Entities That Do Not Have Significant Trading Assets and Liabilities for Section __.5(b) and (c)

For banking entities that do not have significant trading assets and liabilities, the agencies proposed to eliminate the requirements for a separate internal compliance program for risk-mitigating hedging under § __.5(b)(1); certain of the specific requirements of § __.5(b)(2); the limits on compensation arrangements for persons performing risk-mitigating activities in § __.5(b)(3); and the documentation requirements for certain hedging activities in § __.5(c).[511] In place of those requirements, the agencies proposed a new § __.5(b)(2) that would require that the risk-mitigating hedging activities be: (i) At the inception of the hedging activity (including any adjustments), designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including the risks specifically enumerated in the proposal; and (ii) subject to ongoing recalibration, as appropriate, to ensure that the hedge remains designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks.[512] The proposal also included conforming changes to § __.5(b)(1) and § __.5(c) of the 2013 rule to make the requirements of those sections

[499] *See* 2013 rule § __.5(b)(1) and (3).

[500] *See* 2013 rule § __.5(b)(2).

[501] *See* 2013 rule § __.5(c).

[502] *See* 83 FR at 33465.

[503] *See* 83 FR at 33465.

[505] *See id.*

[506] *See* 83 FR at 33465.

[504] *See id.*

[507] 12 U.S.C. 1851(d)(1)(C).

[508] *See* 83 FR at 33465.

[509] *See id.*

[510] *See id.*

[511] *See* 83 FR at 33466.

[512] *Id.*

applicable only to banking entities that have significant trading assets and liabilities.[513]

The agencies explained that these requirements are overly burdensome and complex for banking entities that do not have significant trading assets and liabilities, which are generally less likely to engage in the types of trading activities and hedging strategies that would necessitate these additional compliance requirements. Given these considerations, the agencies believed that removing the requirements for banking entities that do not have significant trading assets and liabilities would be unlikely to materially increase risks to the safety and soundness of the banking entity or U.S. financial stability. The agencies also believed that the proposed requirements for banking entities without significant trading assets and liabilities would effectively implement the statutory requirement that the hedging transactions be designed to reduce specific risks the banking entity incurs.[514]

iv. Reduced Documentation Requirements for Banking Entities That Have Significant Trading Assets and Liabilities for Section __.5(c)

For banking entities that have significant trading assets and liabilities, the agencies proposed to retain the enhanced documentation requirements for the hedging transactions identified in § __.5(c)(1) to permit evaluation of the activity.[515] However, the agencies proposed a new paragraph (c)(4) in § __.5 that would eliminate the enhanced documentation requirement for hedging activities that meets certain conditions.[516] Under new paragraph (c)(4) in § __.5, compliance with the enhanced documentation requirement would not apply to purchases and sales of financial instruments for hedging activities that are identified on a written list of financial instruments pre-approved by the banking entity that are commonly used by the trading desk for the specific types of hedging activity for which the financial instrument is being purchased or sold.[517] In addition, at the time of the purchase or sale of the financial instruments, the related hedging activity would need to comply with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument, which would be required to be appropriate for the size, types, and risks of the hedging activities commonly undertaken by the trading desk; the financial instruments purchased and sold by the trading desk for hedging activities; and the levels and duration of the risk exposures being hedged.[518]

The agencies explained that certain of the regulatory purposes of these documentation requirements, such as facilitating subsequent evaluation of the hedging activity and prevention of evasion, are less relevant in circumstances where common hedging strategies are used repetitively. Therefore the agencies believed that the enhanced documentation requirements were not necessary in such instances and that reducing them would make beneficial risk-mitigating activity more efficient and effective. The agencies intended that the conditions on the pre-approved limits would provide clarity regarding the limits needed to comply with requirements.[519]

c. Commenters' Views

One commenter argued that the requirements associated with the 2013 rule's risk-mitigating hedging exemption have been overly prescriptive, cumbersome, and unnecessary for sound and efficient risk management.[520] Many commenters supported the agencies' efforts to reduce costs and uncertainty and improve the utility of the risk-mitigating hedging exemption.[521] More specifically, commenters agreed with the recommendations to remove the correlation analysis requirement, remove the requirement that a hedge demonstrably reduce or otherwise significantly mitigate one or more specific risks, and reduce the enhanced documentation requirements.[522]

Although some commenters supported the agencies' effort to reduce the compliance burden in the risk-mitigating hedging exemption, others argued that the agencies did not go far enough. Several commenters argued that the agencies should reduce the enhanced documentation requirements and go further to remove these requirements for all banking entities.[523] Another commenter urged the agencies to eliminate the enhanced documentation requirements altogether in light of the proposed rule's robust compliance framework.[524] In addition, a commenter suggested targeted modifications to the provision, including permitting certain types of hedging in line with internal risk limits, allowing aggregate assessment of hedging, and clarifying how firms can comply with the provision.[525]

In contrast, other commenters did not support the agencies' proposed changes to the compliance obligations associated with the risk-mitigating hedging exemption.[526] One commenter argued that eliminating the correlation analysis requirement would eliminate the primary means used by most banks today to ensure a hedging activity is, in fact, offsetting risk.[527] Moreover, the same commenter argued that eliminating the existing regulatory requirement that banks show a hedge "demonstrably reduces" or "significantly mitigates" the risks targeted by the hedge would be a direct repudiation of the statute, because that type of demonstration is required by the statute.[528] Another commenter argued that the various changes proposed by the agencies would lead to uncontrollable speculations.[529]

d. Final Rule

i. Correlation Analysis for Section __.5(b)(1)(i)(C)

The agencies are adopting § __.5(b)(1)(iii) as proposed, but renumbered as § __.5(b)(1)(i)(C). Based on the agencies' implementation experience of the 2013 rule and commenters' feedback on the proposed changes, the agencies are removing the requirement that a correlation analysis be the type of analysis used to assess risk-mitigating hedging activities. The agencies continue to believe, as stated in the proposal, that allowing banking entities to use the type of analysis that is appropriate to the hedging activities in question will avoid the uncertainties discussed in the proposal without substantially impacting the conditions that risk-mitigating hedging activities must meet in order to qualify for the exemption.[530]

Furthermore, section 13 of the BHC Act does not require that the analysis used by the banking entity be a correlation analysis. Instead, the statute only provides that a hedging position,

[513] *Id.*

[514] *Id.*

[515] *Id.*

[516] *Id.*

[517] *Id.*

[518] *Id.*

[519] *See* 83 FR at 33466–67.

[520] *See* SIFMA.

[521] *See, e.g.,* State Street; FSF; ABA; BPI; and SIFMA.

[522] *See, e.g.,* State Street; FSF; ABA; BPI; and SIFMA.

[523] *See, e.g.,* SIFMA; JBA; ABA; BPI; FSF; and CREFC.

[524] *See* BPI.

[525] *See* Credit Suisse.

[526] *See, e.g.,* Volcker Alliance; Bean; Data Boiler; CFA; AFR; NAFCU; Merkley; Better Markets; CAP; Systemic Risk Council; and Public Citizen.

[527] *See* Bean.

[528] *See* Bean.

[529] *See* Data Boiler.

[530] *See* 83 FR at 33465.

technique, or strategy is permitted so long as it is ''. . . designed to reduce the specific risks to the banking entity . . . .'' [531] The agencies believe the continuing requirement that the banking entity conduct ''analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged'' will effectively implement the statute.

The agencies anticipate that the banking entity's flexibility to apply the type of analysis that is appropriate to assess the particular hedging activity at issue will facilitate the appropriate use of risk-mitigating hedging under the exemption. Regarding the comment asserting that correlation analysis is the primary means used by banking entities to test whether a hedging activity is offsetting risk, the agencies note that if this is the case it would be reasonable to expect that the banking entity would use correlation analysis to satisfy the regulatory requirements with respect to that hedging activity. However, if another type of analysis is more appropriate, the banking entity would have the flexibility to use that form of analysis instead.

ii. Hedge Demonstrably Reduces or Otherwise Significantly Mitigates Specific Risks for Sections __.5(b)(1)(i)(C), __.5(b)(1)(ii)(B) and __.5(b)(1)(ii)(D)(2)

The agencies are adopting § __.5(b)(1)(iii), § __.5(b)(2)(ii), and § __.5(b)(2)(iv)(B) as proposed, but renumbered as § __.5(b)(1)(i)(C), § __.5(b)(1)(ii)(B) and § __.5(b)(1)(ii)(D)(2). As stated in the proposal, the requirement that the reduction or mitigation of specific risks resulting from a risk-mitigating hedging activity be demonstrable is not directly required by section 13(d)(1)(C) of the BHC Act.[532] In practice, it appears that the requirement to show that hedging activity demonstrably reduces or otherwise significantly mitigates a specific, identifiable risk that develops over time can be complex and could potentially reduce bona fide risk-mitigating hedging activity. The agencies continue to believe that in some circumstances, it may be difficult for banking entities to know with sufficient certainty that a potential hedging activity that a banking entity seeks to commence will continuously demonstrably reduce or significantly mitigate an identifiable risk after it is implemented, even if the banking entity is able to enter into a hedge reasonably designed to reduce or significantly mitigate such a risk. As stated in the proposal, unforeseeable changes in market conditions, event risk, sovereign risk, and other factors that cannot be known with certainty in advance of undertaking a hedging transaction could reduce or eliminate the otherwise intended hedging benefits.[533] In these events, the requirement that a hedge ''demonstrably reduce'' or ''significantly mitigate'' the identifiable risks could create uncertainty with respect to the hedge's continued eligibility for the exemption. In such cases, a banking entity may determine not to enter into what would otherwise be a reasonably designed hedge of foreseeable risks out of concern that the banking entity may not be able to effectively comply with the requirement that such a hedge demonstrably reduces such risks due to the possibility of unforeseen risks occur. Therefore, the final rule removes the ''demonstrably reduces or otherwise significantly mitigates'' specific risk requirement from § __.5(b)(1)(i)(C), § __.5(b)(1)(ii)(B) and § __.5(b)(1)(ii)(D)(2).

The agencies do not agree with a commenter's assertion that the requirement that banking entities show that a hedge ''demonstrably'' reduces or significantly mitigates the risks is a core requirement under section 13 of the BHC Act. Instead, the statute expressly permits hedging activities that are ''designed to reduce the specific risks of the banking entity.'' [534] The final rule maintains the requirement that hedging activity undertaken pursuant to § __.5 be designed to reduce or otherwise mitigate specific, identifiable risks. Hedging activity must also be subject to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirement that the activity is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks even after changes in market conditions or other factors. In light of these requirements, the agencies do not find it necessary to require that the hedge ''demonstrably reduce'' risk to the banking entity on an ongoing basis.

iii. Reduced Compliance Requirements for Banking Entities That Do Not Have Significant Trading Assets and Liabilities for Section __.5(b)(2) and Section __.5(c)

The agencies are adopting §§ __.5(b)(2) and __.5(c) as proposed. Consistent with the changes in the final rule relating to the scope of the requirements for banking entities that do not have significant trading assets and liabilities, the agencies are also revising the requirements in §§ __.5(b)(2) and __.5(c) for banking entities that do not have significant trading assets and liabilities. For these firms, the agencies are eliminating the requirements for a separate internal compliance program for risk-mitigating hedging under § __.5(b)(1); certain of the specific requirements of § __.5(b)(2); the limits on compensation arrangements for persons performing risk-mitigating activities in § __.5(b)(1)(iii); and the documentation requirements for those activities in § __.5(c). Based on comments received, the agencies have determined that these requirements are overly burdensome and complex for banking entities with moderate trading assets and liabilities, in light of the reduced scale of their trading and hedging activities.

In place of those requirements, new § __.5(b)(2) requires that risk-mitigating hedging activities for those banking entities be: (i) At the inception of the hedging activity (including any adjustments), designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including the risks specifically enumerated in the proposal; and (ii) subject to ongoing recalibration, as appropriate, to ensure that the hedge remains designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks. The agencies continue to believe that these tailored requirements for banking entities without significant trading assets and liabilities effectively implement the statutory requirement that the hedging transactions be designed to reduce specific risks the banking entity incurs. The agencies believe that the remaining requirements for a firm with moderate trading assets and liabilities would be effective in ensuring such banking entities engage only in permissible risk-mitigating hedging activities. The agencies also note that reducing these compliance requirements for banking entities that do not have significant trading assets and liabilities is unlikely to materially increase risks to the safety and soundness of the banking entity or

[531] 12 U.S.C. 1851(d)(1)(C).

[532] *See* 83 FR at 33465.

[533] *See id.*

[534] 12 U.S.C. 1851(d)(1)(C).

U.S. financial stability. Therefore, the agencies are eliminating and modifying these requirements for banking entities that do not have significant trading assets and liabilities. In connection with these changes, the final rule also includes conforming changes to §§ ▮▮.5(b)(1) and ▮▮.5(c) of the 2013 rule to make the requirements of those sections applicable only to banking entities that have significant trading assets and liabilities.

iv. Reduced Documentation Requirements for Banking Entities That Have Significant Trading Assets and Liabilities for Section ▮▮.5(c)

The agencies are adopting § ▮▮.5(c) as proposed. The final rule retains the enhanced documentation requirements for banking entities that have significant trading assets and liabilities for hedging transactions identified in § ▮▮.5(c)(1) to permit evaluation of the activity. Although this documentation requirement results in more extensive compliance efforts, the agencies continue to believe it serves an important role to prevent evasion of the requirements of section 13 of the BHC Act and the final rule.

The hedging transactions identified in § ▮▮.5(c)(1) include hedging activity that is not established by the specific trading desk that creates or is responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce; is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or established to hedge aggregated positions across two or more trading desks. The agencies believe that hedging transactions established at a different trading desk, or which are not identified in the relevant policies, may present or reflect heightened potential for prohibited proprietary trading. In other words, the further removed hedging activities are from the specific positions, contracts, or other holdings the banking entity intends to hedge, the greater the danger that such activity is not limited to hedging specific risks of individual or aggregated positions, contracts, or other holdings of the banking entity. For this reason, the agencies do not agree with commenters who argued that the enhanced documentation requirements should be removed for all banking entities.

However, based on the agencies' experience during the first several years of implementation of the 2013 rule, it appears that many hedges established by one trading desk for other affiliated desks are often part of common hedging strategies that are used regularly and that do not raise the concerns of those trades prohibited by the rule. In those instances, the documentation requirements of § ▮▮.5(c) of the 2013 rule are less necessary for purposes of evaluating the hedging activity and preventing evasion. In weighing the significantly reduced regulatory and supervisory utility of additional documentation of common hedging trades against the complexity of complying with the enhanced documentation requirements, the agencies have determined that the documentation requirements are not necessary in those instances. Reducing the documentation requirement for common hedging activity undertaken in the normal course of business for the benefit of one or more other trading desks would also make beneficial risk-mitigating activity more efficient and potentially improve the timeliness of important risk-mitigating hedging activity, the effectiveness of which can be time sensitive.

Therefore, § ▮▮.5(c)(4) of the final rule eliminates the enhanced documentation requirement for hedging activities that meet certain conditions. In excluding a trading desk's common hedging instruments from the enhanced documentation requirements in § ▮▮.5(c), the final rule seeks to distinguish between those financial instruments that are commonly used for a trading desk's ordinary hedging activities and those that are not. The final rule requires the banking entity to have in place appropriate limits so that less common or more unusual levels of hedging activity would still be subject to the enhanced documentation requirements. The final rule provides that the enhanced documentation requirement does not apply to purchases and sales of financial instruments for hedging activities that are identified on a written list of financial instruments pre-approved by the banking entity that are commonly used by the trading desk for the specific types of hedging activity for which the financial instrument is being purchased or sold. In addition, at the time of the purchase or sale of the financial instruments, the related hedging activity would need to comply with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument. These hedging limits must be appropriate for the size, types, and risks of the hedging activities commonly undertaken by the trading desk; the financial instruments purchased and sold by the trading desk for hedging activities; and the levels and duration of the risk exposures being hedged. These conditions on the pre-approved limits are intended to provide clarity as to the types and characteristics of the limits needed to comply with the final rule. The pre-approved limits should be reasonable and set to correspond to the type of hedging activity commonly undertaken and at levels consistent with the hedging activity undertaken by the trading desk in the normal course.

The agencies considered comments that suggested additional targeted modifications to the risk-mitigating hedging requirements, but believe that the suggested modifications would add additional complexity and administrative burden without significantly changing the efficiency and effectiveness of the final rule. Additionally, the agencies believe that because the final rule maintains significant requirements for hedging activities to qualify for the exemption, it should not lead to uncontrollable speculation, as one commenter warned.

4. Section ▮▮.6(e): Permitted Trading Activities of a Foreign Banking Entity

Section 13(d)(1)(H) of the BHC Act [535] permits certain foreign banking entities to engage in proprietary trading that occurs solely outside of the United States (the foreign trading exemption); [536] however, the statute does not define when a foreign banking entity's trading occurs ''solely outside of the United States.'' The 2013 rule includes several conditions on the availability of the foreign trading exemption. Specifically, in addition to limiting the exemption to foreign banking entities where the purchase or sale is made pursuant to paragraph (9)

[535] Section 13(d)(1)(H) of the BHC Act permits trading conducted by a foreign banking entity pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act (12 U.S.C. 1843(c)), if the trading occurs solely outside of the United States, and the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States. *See* 12 U.S.C. 1851(d)(1)(H).

[536] This section's discussion of the concept of ''solely outside of the United States'' is provided solely for purposes of the rule's implementation of section 13(d)(1)(H) of the BHC Act and does not affect a banking entity's obligation to comply with additional or different requirements under applicable securities, banking, or other laws. Among other differences, section 13 of the BHC Act does not necessarily include the customer protection, transparency, anti-fraud, anti-manipulation, and market orderliness goals of other statutes administered by the agencies. These other goals or other aspects of those statutory provisions may require different approaches to the concept of ''solely outside of the United States'' in other contexts.

or (13) of § ▮▮.4(c) of the BHC Act,[537] the 2013 rule provides that the foreign trading exemption is available only if: [538]

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate, or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State.

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State.

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

(iv) No financing for the banking entity's purchase or sale is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State (the financing prong).

(v) The purchase or sale is not conducted with or through any U.S. entity,[539] except if the purchase or sale is conducted:

(A) With the foreign operations of a U.S. entity, if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation or execution of such purchase or sale (the counterparty prong); [540]

(B) with an unaffiliated market intermediary acting as principal, provided the transaction is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

(C) through an unaffiliated market intermediary, provided the transaction is conducted anonymously (*i.e.,* each party to the transaction is unaware of the identity of the other party(ies)) on an exchange or similar trading facility and promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.

Since the adoption of the 2013 rule, foreign banking entities have asserted that certain of these criteria limit their ability to make use of the statutory exemption for trading activity that occurs outside of the United States, which has adversely impacted their foreign trading operations. Additionally, many foreign banking entities have suggested that the full set of eligibility criteria to rely on the exemption for foreign trading activity are unnecessary to accomplish the policy objectives of section 13 of the BHC Act. This information has raised concerns that the current requirements for the exemption may be overly restrictive and not effective in permitting foreign banks to engage in foreign trading activities consistent with the policy objective of the statute.

The proposal would have modified the requirements for the foreign trading exemption so that it would be more usable by foreign banking entities. Specifically, the proposal would have retained the first three requirements of the 2013 rule, with a modification to the first requirement, and would have removed the last two requirements of § ▮▮.6(e)(3). As a result, § ▮▮.6(e)(3), as modified by the proposal, would have required that for a foreign banking entity to be eligible for this exemption:

(i) The banking entity engaging as principal in the purchase or sale (including relevant personnel) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

The proposal would have maintained these three requirements in order to ensure that the banking entity (including any relevant personnel) that engages in the purchase or sale as principal or makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or any State. Furthermore, the proposal would have retained the 2013 rule's requirement that the purchase or sale, including any transaction arising from a related risk-mitigating hedging transaction, may not be accounted for as principal by the U.S. operations of the foreign banking entity. However, the proposal would have replaced the first requirement that any personnel of the banking entity that arrange, negotiate, or execute such purchase or sale are not located in the United States with one that would restrict only the relevant personnel engaged in the banking entity's decision in the purchase or sale are not located in the United States.

Under the proposed approach, the requirements for the foreign trading exemption focused on whether the banking entity that engages in or that decides to engage in the purchase or sale as principal (including any relevant personnel) is located in the United States. The proposed modifications recognized that some limited involvement by U.S. personnel (*e.g.,* arranging or negotiating) would be consistent with this exemption so long as the principal risk and actions of the purchase or sale do not take place in the United States for purposes of section 13 of the BHC Act and the implementing regulations.

The proposal also would have eliminated the financing prong and the counterparty prong. Under the proposal, these changes would have focused the key requirements of the foreign trading exemption on the principal actions and risk of the transaction. In addition, the proposal would have removed the financing prong to address concerns that the fungibility of financing has made this requirement in certain circumstances difficult to apply in practice to determine whether a particular financing is tied to a particular trade. Market participants have raised a number of questions about the financing prong and have indicated that identifying whether financing has been provided by a U.S. affiliate or branch can be exceedingly complex, in particular with respect to demonstrating that financing has not been provided by a U.S. affiliate or branch with respect to a particular transaction. To address the concerns raised by foreign banking entities and other market participants, the proposal would have amended the exemption to focus on the principal risk of a transaction and the location of the actions as principal and trading decisions, so that a foreign banking entity would be able to make use of the exemption so long as the risk of the transaction is booked outside of the United States. While the agencies

[537] 12 U.S.C. 1843(c)(9), (13). *See* 2013 rule § ▮▮.6(e)(1)(i) and (ii).

[538] *See* 2013 rule § ▮▮.6(e).

[539] "U.S. entity" is defined for purposes of this provision as any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State. *See* 2013 rule § ▮▮.6(e)(4).

[540] A foreign banking entity wishing to engage in trading activities with a U.S. entity's foreign affiliate generally must rely on the counterparty prong.

recognize that a U.S. branch or affiliate that extends financing could bear some risks, the agencies note that the proposed modifications to the foreign trading exemption were designed to require that the principal risks of the transaction occur and remain solely outside of the United States.

Similarly, foreign banking entities have communicated to the agencies that the counterparty prong has been overly difficult and costly for banking entities to monitor, track, and comply with in practice. As a result, the agencies proposed to remove the requirement that any transaction with a U.S. counterparty be executed solely with the foreign operations of the U.S. counterparty (including the requirement that no personnel of the counterparty involved in the arrangement, negotiation, or execution may be located in the United States) or through an unaffiliated intermediary and an anonymous exchange. These changes were intended to materially reduce the reported inefficiencies associated with rule compliance. In addition, market participants have indicated that this requirement has in practice led foreign banking entities to overly restrict the range of counterparties with which transactions can be conducted, as well as disproportionately burdened compliance resources associated with those transactions, including with respect to counterparties seeking to do business with the foreign banking entity in foreign jurisdictions.

The proposal would have removed the counterparty prong and focused the requirements of the foreign trading exemption on the location of a foreign banking entity's decision to trade, action as principal, and principal risk of the purchase or sale. This proposed focus on the location of actions and risk as principal in the United States was intended to align with the statute's definition of ''proprietary trading'' as ''engaging *as principal for the trading account of the banking entity*.'' [541] The proposal would have scaled back those requirements that were not critical for this determination and thus would not be needed in the final rule. Therefore, the proposal would have removed the requirements of § ■■.6(e)(3) since they are less directly relevant to these considerations.

Consistent with the 2013 rule, the exemption under the proposal would not have exempted the U.S. or foreign operations of U.S. banking entities from having to comply with the restrictions and limitations of section 13 of the BHC Act. Thus, for example, the U.S. and foreign operations of a U.S. banking entity that is engaged in permissible market making-related activities or other permitted activities may engage in those transactions with a foreign banking entity that is engaged in proprietary trading in accordance with the exemption under § ■■.6(e) of the 2013 rule, so long as the U.S. banking entity complies with the requirements of § ■■.4(b), in the case of market making-related activities, or other relevant exemption applicable to the U.S. banking entity. The proposal, like the 2013 rule, would not have imposed a duty on the foreign banking entity or the U.S. banking entity to ensure that its counterparty is conducting its activity in conformance with section 13 and the implementing regulations. Rather, that obligation would have been on each party subject to section 13 to ensure that it is conducting its activities in accordance with section 13 and the implementing regulations.

The proposal's exemption for trading of foreign banking entities outside the United States potentially could have given foreign banking entities a competitive advantage over U.S. banking entities with respect to permitted activities of U.S. banking entities because foreign banking entities could trade directly with U.S. counterparties without being subject to the limitations associated with the market making-related activities exemption or other exemptions under the rule. This competitive disparity in turn could create a significant potential for regulatory arbitrage. In this respect, the agencies sought to mitigate this concern through other changes in the proposal; for example, U.S. banking entities would have continued to be able to engage in all of the activities permitted under the 2013 rule and the proposal, including the simplified and streamlined requirements for market making and risk-mitigating hedging and other types of trading activities.

In general, commenters supported the proposed changes.[542] However, a number of commenters requested further modifications to the foreign trading exemption. For example, some commenters requested that the agencies clarify the definition of ''relevant personnel'' to mean employees that conduct risk management, and not the traders or others associated with executing the transaction.[543] One commenter requested clarification that the proposed changes not constrain foreign banking entities from delegating investment authority to non-affiliated U.S. investment advisers.[544] Another commenter supported eliminating the conduct restriction.[545] One commenter proposed several additional modifications, including further simplifying the exemption to only focus on where the transaction is booked, clarifying certain terms (*e.g.,* sub-servicing, dark pools, engaging in), and including inter-affiliate or intra-bank transactions in the exemption.[546] This commenter also requested that the agencies include execution as one of the examples of limited involvement.[547]

A few commenters opposed the proposed changes to eliminate the financing and counterparty requirements.[548] These commenters argued that the proposed changes might provide foreign entities with a competitive advantage over domestic entities.[549] One commenter asserted that the proposed changes would increase uncertainty and could increase the exposure of U.S. institutions to foreign proprietary trading losses.[550] This commenter also argued that the agencies did not provide factual data to support the change and that the proposal was contrary to law.[551]

After consideration of these comments, the agencies are adopting the changes to the foreign trading exemption as proposed. The proposal's modifications in general sought to balance concerns regarding competitive impact while mitigating the concern that an overly narrow approach to the foreign trading exemption may cause market bifurcations, reduce the efficiency and liquidity of markets, make the exemption overly restrictive to foreign banking entities, and harm U.S. market participants. The agencies believe that this approach appropriately balances one of the key objectives of section 13 of the BHC Act by limiting the risks that proprietary trading poses to the U.S. financial system, while also modifying the application of section 13 as it applies to foreign banking entities, as required by section 13(d)(1)(H).

As noted in the preamble to the proposal, the statute contains an exemption that allows foreign banking entities to engage in trading activity that is, only for purposes of the prohibitions of the statute, solely outside the United

[541] *See* 12 U.S.C. 1851(h)(4) (emphasis added).

[542] *See, e.g.,* ISDA; IIB; ABA; New England Council; BVI; HSBC; EBF; Credit Suisse; JBA FSF; and EFAMA.

[543] *See, e.g.,* HSBC and JBA.

[544] *See* EFAMA.

[545] *See* HSBC.

[546] *See* JBA.

[547] *See* JBA.

[548] *See, e.g.,* Bean; Data Boiler; and Better Markets.

[549] *See, e.g.,* Better Markets and FSF.

[550] *See* Bean.

[551] *See* Bean.

States. The statute also contains a prohibition on proprietary trading for U.S. banking entities regardless of where their activity is conducted. The statute generally prohibits U.S. banking entities from engaging in proprietary trading because of the perceived risks of those activities to U.S. banking entities and the U.S. financial system. The modified foreign trading exemption excludes from the statutory prohibitions transactions where the principal risk is booked outside of the United States and the actions and decisions as principal occur outside of the United States by foreign operations of foreign banking entities. The agencies also are confirming that the foreign trading 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. By continuing to limit the risks of foreign banking entities' proprietary trading activities to the U.S. financial system, the agencies believe that the rule continues to protect and promote the safety and soundness of banking entities and the financial stability of the United States, while also allowing U.S. markets to continue to operate efficiently in conjunction with foreign markets.

C. Subpart C—Covered Fund Activities and Investments

1. Overview of Agencies' Approach to the Covered Fund Provisions

The proposal included several proposed revisions to subpart C (the covered fund provisions). The proposal also sought comments on other aspects of the covered fund provisions beyond those changes for which specific rule text was proposed. As described further below, the agencies have determined to adopt, as proposed, the changes to subpart C for which specific rule text was proposed. The agencies continue to consider other aspects of the covered fund provisions on which the agencies sought comment in the proposal and intend to issue a separate proposed rulemaking that specifically addresses those areas.

The proposal sought comment on the 2013 rule's general approach to defining the term "covered fund," as well as the existing exclusions from the covered fund definition and potential new exclusions from this definition. The agencies received numerous comments on these aspects of the covered fund provisions. Some commenters encouraged the agencies to make significant revisions to these provisions, such as narrowing the covered fund "base definition" [552] or providing additional exclusions from this definition.[553] Other commenters argued that the agencies should not narrow the covered fund definition or should retain the definition in section 13 of the BHC Act.[554] Some commenters raised concerns about the agencies' ability to finalize changes to the covered fund provisions for which the proposal did not provide specific rule text.[555] In light of the number and complexity of issues under consideration, the agencies intend to address these and other comments received on the covered fund provisions in a subsequent proposed rulemaking.

In this final rule, the agencies are adopting only those changes to the covered fund provisions for which specific rule text was proposed.[556] Those changes are being adopted as final without change from the proposal for the reasons described below. While the agencies are not including any other changes to subpart C in this final rule, this approach does not reflect any final determination with respect to the comments received on other aspects of the covered fund provisions. The agencies continue to consider comments received and intend to address additional aspects of the covered funds provisions in the future covered funds proposal.

2. Section ■■.11: Permitted Organizing and Offering, Underwriting, and Market Making With Respect to a Covered Fund

Section 13(d)(1)(B) of the BHC Act permits a banking entity to purchase and sell securities and other instruments described in section 13(h)(4) of the BHC Act in connection with the banking entity's underwriting or market making-related activities.[557] The 2013 rule provides that the prohibition against acquiring or retaining an ownership interest in or sponsoring a covered fund does not apply to a banking entity's underwriting or market making-related activities involving a covered fund as long as:

- The banking entity conducts the activities in accordance with the requirements of the underwriting exemption in § ■■.4(a) of the 2013 rule or market making exemption in § ■■.4(b) of the 2013 rule, respectively.
- The banking entity includes the aggregate value of all ownership interests of the covered fund acquired or retained by the banking entity and its affiliates for purposes of the limitation on aggregate investments in covered funds (the aggregate-fund limit) [558] and capital deduction requirement; [559] and
- The banking entity includes any ownership interest that it acquires or retains for purposes of the limitation on investments in a single covered fund (the per-fund limit) if the banking entity (i) acts as a sponsor, investment adviser or commodity trading adviser to the covered fund; (ii) otherwise acquires and retains an ownership interest in the covered fund in reliance on the exemption for organizing and offering a covered fund in § ■■.11(a) of the 2013 rule; (iii) acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act, or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act and the implementing regulations issued thereunder, each as permitted by § ■■.11(b) of the 2013 rule; or (iv) directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests.[560]

The proposal would have removed the requirement that the banking entity include for purposes of the aggregate fund limit and capital deduction the value of any ownership interests of a third-party covered fund (*i.e.,* covered funds that the banking entity does not advise or organize and offer pursuant to § ■■.11 of the final rule) acquired or retained in accordance with the underwriting or market-making exemptions in § ■■.4. Under the proposal, these limits, as well as the per-fund limit, would have applied only to a covered fund that the banking entity organizes or offers and in which the banking entity acquires or retains an ownership interest pursuant to § ■■.11(a) or (b) of the 2013 rule. The agencies proposed this change to more closely align the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in a covered fund with the requirements for engaging in these activities with respect to other financial instruments.

[552] *See, e.g.,* ABA; AIC; Center for American Entrepreneurship; Goldman Sachs; and JBA.

[553] *See, e.g.,* Capital One et al.; Credit Suisse; and SIFMA.

[554] *See, e.g.,* AFR and Occupy the SEC.

[555] *See, e.g.,* AFR; Bean; and Volcker Alliance.

[556] In addition, consistent with changes described in Part IV.B.1.b.i of this **SUPPLEMENTARY INFORMATION**, the final rule removes references to "guidance" from subpart C.

[557] 12 U.S.C. 1851(d)(1)(B).

[558] 2013 rule § ■■.12(a)(2)(iii).

[559] 2013 rule § ■■.12(d).

[560] *See* 2013 rule § ■■.11(c).

Several commenters supported eliminating these requirements for underwriting and market making in ownership interests in covered funds.[561] Many of these commenters said this proposal would reduce the compliance burden for banking entities engaged in client-facing underwriting and market making activities and would facilitate these permitted activities.[562] One of these commenters noted in particular the difficulties for banking entities to determine whether a third-party fund is a covered fund subject to the limits of the 2013 rule and to determine with certainty whether certain non-U.S. securities may be issued by covered funds.[563] Some of these commenters argued that providing underwriting and market making in the interests in such funds increases liquidity and benefits the marketplace generally.[564] One of these commenters also stated that this would facilitate capital-raising activities of covered funds and other issuers.[565] Other commenters opposed this change because they believed that it would greatly expand banking entities' ability to hold ownership interests in covered funds,[566] and is contrary to section 13 of the BHC Act.[567]

Several commenters supported making additional revisions to § ▮▮.11 by eliminating the aggregate fund limit and capital deduction for other funds, such as affiliated funds or sponsored funds [568] and advised funds.[569] Certain of these commenters argued that underwriting and market making in interests in these covered funds would not expose banking entities to greater risk because ownership interests in such funds acquired in accordance with the risk-mitigating hedging, market-making or underwriting exemptions would nevertheless be subject to the restrictions contained in those exemptions.[570]

The agencies are eliminating the aggregate fund limit and the capital deduction requirement for the value of ownership interests in third-party covered funds acquired or retained in accordance with the underwriting or market-making exemption (*i.e.,* covered funds that the banking entity does not advise or organize and offer pursuant to § ▮▮.11(a) or (b) of the final rule).[571] The agencies believe this change will better align the compliance requirements for underwriting and market making involving covered funds with the risks those activities entail. In particular, the agencies understand that it has been difficult for banking entities to determine whether ownership interests in covered funds are being acquired or retained in the context of trading activities, especially for non-U.S. issuers. Banking entities have had to undertake an often time-consuming process to determine whether an issuer is a covered fund and the security issued is an ownership interest, all for the purpose of ensuring compliance with the aggregate fund limit and capital deduction requirement for the period of time that the banking entity holds the ownership interest as part of its otherwise permissible underwriting and market making activities.[572] These compliance challenges are heightened in the case of third-party funds. However, a banking entity can more readily determine whether a fund is a covered fund if the banking entity advises or organizes and offers the fund. Thus, the agencies are not eliminating the aggregate fund limit and capital deduction requirement for advised covered funds or covered funds that the banking entity organizes or offers. The agencies continue to consider whether the approach being adopted in the final rule may be extended to other issuers, such as funds advised by the banking entity, and intend to address and request additional comment on this issue in the future proposed rulemaking.

The agencies disagree with the commenter who argued that eliminating the aggregate fund limit and capital deduction is contrary to section 13 of the BHC Act.[573] An exemption from the prohibition on acquiring or retaining an ownership interest in a covered fund for underwriting and market making involving covered fund ownership interests is consistent with and supported by section 13 of the BHC Act.[574] Section 13(d)(1)(B) provides a statutory exemption for underwriting and market making activities and, by its terms, applies to both prohibitions in section 13(a), whether on proprietary trading or covered fund activities. Section 13 does not require any per-fund or aggregate limits, or capital deduction, with respect to covered fund ownership interests acquired pursuant to the underwriting and market making exemption in section 13(d)(1)(B), and eliminating these requirements with respect to third-party funds will improve the effectiveness of the statutory exemption for these activities.[575]

The agencies also disagree with commenters who asserted that this change will greatly expand banking entities' ability to hold ownership interests in covered funds.[576] This exemption for underwriting and market making involving ownership interests in covered funds applies only to underwriting and market making activities conducted pursuant to the requirements in section 13(d)(1)(B) of the BHC Act and § ▮▮.4 of the final rule. This exemption is intended to allow banking entities to engage in permissible underwriting and market making involving covered fund ownership interests to the same extent as other financial instruments. It is also intended to increase the effectiveness of the underwriting and market making exemptions in § ▮▮.4 by appropriately limiting the covered fund determinations a banking entity must make in the course of these permissible activities. For these reasons, and to limit the potential for evasion, the exemption for underwriting and market making involving ownership interests in covered funds continues to apply only to activities that satisfy the requirements of the underwriting or market making exemptions in § ▮▮.4.

One commenter argued that the aggregate fund limit should apply only at the global consolidated level for all firms.[577] This commenter argued that measuring aggregate covered fund ownership at the parent-level is a better test of immateriality than measuring covered fund investments at a lower level, such as at the level of an

[561] *See, e.g.,* ABA; BPI; FSF; Goldman Sachs; IIB; ISDA; and SIFMA.

[562] *See, e.g.,* BPI; FSF; ISDA; and SIFMA.

[563] *See* SIFMA.

[564] *See* ISDA.

[565] *See* SIFMA.

[566] *See, e.g.,* AFR; Bean; and Volcker Alliance.

[567] *See* Bean.

[568] *See* ISDA.

[569] *See, e.g.,* BPI; ISDA; and SIFMA.

[570] *See, e.g.,* BPI and ISDA.

[571] As in the proposal, this requirement is also eliminated for underwriting and market-making activities involving funds with respect to which the banking entity directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests. Such funds are not organized and offered pursuant to § ▮▮.11(a) or (b) of the final rule and thus treatment as a third-party fund is more appropriate for purposes of the underwriting and market-making exemption for covered funds. The agencies note, however, that other provisions of section 13 of the BHC Act, as well as other laws and regulations, limit banking entities' ability to guarantee, assume, or otherwise insure the obligations or performance of covered funds. See 12 U.S.C. 1851(f); 12 U.S.C. 1851(d)(2); §§ ▮▮.14 and ▮▮.15 of the final rule. See also 12 CFR 7.1017 (limiting authority of national bank to act as a guarantor).

[572] *See* SIFMA.

[573] *See* Bean.

[574] *See* 79 FR 5535, 5722.

[575] The quantitative limits and capital deduction requirements in 12 U.S.C. 1851(d)(4)(B) are required to apply only in the case of seeding investments and other *de minimis* investments made pursuant to 12 U.S.C. 1851(d)(4)(B).

[576] *See, e.g.,* AFR; Bean; and Volcker Alliance.

[577] *See* Credit Suisse.

intermediate holding company.[578] This commenter also said the agencies should expand the per-fund limit to allow bank-affiliated securitization investment managers to rely on applicable foreign risk retention regulations as a basis for exceeding the three percent per-fund limitation, provided that those foreign regulations are generally comparable to U.S. requirements.[579] Another commenter asserted that the preamble to the 2013 rule indicated that direct investments made alongside a covered fund should be aggregated for purposes of the per-fund limit in certain circumstances.[580] This commenter asked the agencies to clarify that the 2013 rule does not prohibit banking entities from making direct investments alongside covered funds, regardless of whether the fund is sponsored or the investments are coordinated, so long as such investments are otherwise authorized for such banking entities (*e.g.,* under merchant banking authority). The agencies continue to consider these issues. As noted above, the agencies expect to address and request additional comments on these and other covered fund provisions in the future proposed rulemaking.

3. Section ___.13: Other Permitted Covered Fund Activities

a. Permitted Risk-Mitigating Hedging

Section 13(d)(1)(C) of the BHC Act provides an exemption for risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.[581] As described in the preamble to the proposal, the 2013 rule implemented this authority narrowly in the context of covered fund activities. Specifically, the 2013 rule permitted only limited risk-mitigating hedging activities involving ownership interests in covered funds for hedging employee compensation arrangements.

Like the proposal, the final rule allows a banking entity to acquire or retain an ownership interest in a covered fund as a hedge when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund. This provision is consistent with the agencies' original 2011 proposal.[582]

The proposal also would have amended § ___.13(a) to align with the proposed modifications to § ___.5. In particular, the proposal would have required that a risk-mitigating hedging transaction pursuant to § ___.13(a) be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks to the banking entity. It would have removed the requirement that the hedging transaction ''demonstrably'' reduces or otherwise significantly mitigates the relevant risks, consistent with the proposed modifications to § ___.5.[583]

Several commenters supported permitting banking entities to acquire and retain ownership interests in covered funds as a hedge when acting as intermediary on behalf of a customer.[584] Certain of these commenters argued that acquiring or retaining ownership interests in covered funds for this purpose (fund-linked products) is beneficial because it accommodates banking entities' client facilitation and related risk management activities.[585] Two commenters noted that restricting institutions' ability to find the best hedge for a transaction may increase risks to safety and soundness and, conversely, permitting banking entities to use the best available hedge for risks arising from customer facilitation activities would promote safety and soundness and reduce risk.[586] Several of these commenters also argued that fund-linked products are not a high-risk trading strategy.[587] For example, one commenter argued that the magnitude of counterparty default risk that banking entities would face in acquiring or retaining a covered fund ownership interest under these circumstances (*i.e.,* to hedge a position by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate exposure by the customer to a covered fund) is no different than any other counterparty default risk that banking entities face when entering into other risk-mitigating hedges.[588] Other commenters opposed this change and noted that, at the time the 2013 rule was adopted, the agencies considered acting as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the banking entity with ownership interests of the covered fund, to constitute a high-risk trading strategy.[589] One commenter stated that the proposal did not offer specific examples or explain why such fund-linked products are necessary.[590] Another commenter argued that the exemption for risk-mitigating hedging involving ownership interests in covered funds should be further restricted or completely removed from the rule.[591]

The final rule adopts the proposed revision without change. This exemption is tailored to permit bona fide customer facilitation activities and to limit the risk incurred directly by the banking entity. The new exemption in § ___.13(a) extends only to a position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the customer's exposure to the profits and losses of the covered fund. The banking entity's acquisition or retention of the ownership interest as a hedge must be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund. As a result, a transaction conducted in reliance on this exemption must be customer-driven. A banking entity cannot rely on this exemption to solicit customer transactions in order to facilitate the banking entity's own exposure to a covered fund.

As some commenters noted, in the preamble to the 2013 rule, the agencies stated that they were not adopting an exemption for customer facilitation activities and related hedging activities involving ownership interests in covered funds because these activities could potentially expose a banking entity to the types of risks that section 13 of the BHC Act sought to address. However, in light of other comments received,[592] the agencies do not believe that a banking entity's customer facilitation activities and related hedging activities involving ownership interests in covered funds necessarily constitute high-risk trading strategies that could threaten the safety and soundness of the banking entity. The agencies believe that, properly monitored and managed, these activities can be conducted without creating a greater degree of risk to the banking entity than the other customer facilitation activities permitted by the

[578] *Id.*
[579] *Id.*
[580] *See* Goldman Sachs.
[581] 12 U.S.C. 1851(d)(1)(C).
[582] *See* 83 FR at 33483–84.
[583] *See* supra Part IV.B.3.b.ii.
[584] *See, e.g.,* ABA; BPI; FSF; Goldman Sachs; IIB; ISDA; SIFMA; and IIB.
[585] *See, e.g.,* BPI and FSF.
[586] *See, e.g.,* FSF and SIFMA.
[587] *See, e.g.,* FSF; ISDA; and SIFMA.
[588] *See* FSF.
[589] *See, e.g.,* AFR and Volcker Alliance.
[590] *See* AFR.
[591] *See* Occupy the SEC.
[592] *See, e.g.,* FSF; ISDA; and SIFMA.

final rule.[593] In particular, these activities remain subject to all of the final rule's requirements for risk-mitigating hedging transactions, including requirements that such transactions must:

• Be designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity;

• be made in accordance with the banking entity's written policies, procedures and internal controls;

• not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with the risk-mitigating hedging requirements; and

• be subject to continuing review, monitoring and management by the banking entity.[594]

In addition, these activities remain subject to § ■ ■.15 of the final rule and, therefore, to the extent they would in practice significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States, they would not be permissible. The agencies are also adopting without change the amendment to align § ■ ■.13(a) with § ■ ■.5 by eliminating the requirement that a risk-mitigating hedging transaction ''demonstrably'' reduces or otherwise significantly mitigates the relevant risks. The agencies are adopting this amendment to § ■ ■.13(a) for the same reason the agencies are adopting the amendment to § ■ ■.5.

b. Permitted Covered Fund Activities and Investments Outside of the United States

Section 13(d)(1)(I) of the BHC Act permits foreign banking entities to acquire or retain an ownership interest in, or act as sponsor to, a covered fund, so long as those activities and investments occur solely outside the United States and certain other conditions are met (the foreign fund exemption).[595] Section 13 of the BHC Act does not further define ''solely outside of the United States'' (SOTUS).

The 2013 rule established several conditions on the availability of the foreign fund exemption. Specifically, the 2013 rule provided that an activity or investment occurs solely outside the United States for purposes of the foreign fund exemption only if:

• The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

• The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State;

• The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and

• No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State (the ''financing prong'').[596]

Much like the similar requirement under the exemption for permitted trading activities of a foreign banking entity, the proposal would have removed the financing prong of the foreign fund exemption, while leaving in place the other requirements for an activity or investment to be considered ''solely outside of the United States.'' Removing the financing prong was intended to streamline the requirements of the foreign fund exemption with the intention of improving implementation of the statutory exemption.

Several commenters supported removing the financing prong from the foreign fund exemption.[597] One commenter argued that this change would appropriately refocus the foreign fund exemption on the location of the activities of the banking entity as principal.[598] Another commenter argued that the proposed changes to the foreign fund exemption, including removal of the financing prong, could promote international regulatory cooperation.[599] Other commenters argued against eliminating the financing prong because it could result in a U.S. branch or affiliate that extends financing to bear some risks.[600]

The agencies are adopting the proposal to remove the financing prong for the same reasons described above in section IV.B.4 for the trading outside of the United States exemption. This change focuses one of the key requirements of the foreign fund exemption on the principal actions and risk of the transaction. Removing the financing prong would also address concerns that the fungibility of financing has made this requirement in certain circumstances difficult to apply in practice to determine whether a particular financing is tied to a particular activity or investment. Eliminating the financing prong, while retaining the other prongs of the foreign fund exemption, strikes a better balance between the risks posed to U.S. banking entities and the U.S. financial system, on the one hand, and effectuating the statutory exemption for activities conducted solely outside of the United States, on the other. The agencies note that a U.S. banking entity's affiliate lending activities remain subject to other laws and regulations—including sections 23A and 23B of the Federal Reserve Act and prudential safety and soundness standards, as applicable.

One of the restrictions of the statutory exemption for covered fund activities conducted by foreign banking entities solely outside the United States is the restriction that ''no ownership interest in such hedge fund or private equity fund is be offered for sale or sold to a resident of the United States.[601] To implement this restriction, § ■ ■.13(b) of the 2013 rule requires, as one condition of the foreign fund exemption, that ''no ownership interest in the covered fund is offered for sale or sold to a resident of the United States'' (the ''marketing restriction'').[602]

The final rule, like the proposal, clarifies 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 only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. The final

[593] *See, e.g.,* final rule § ■ ■.3(d)(11).

[594] *See* final rule § ■ ■.13.

[595] Section 13(d)(1)(I) of the BHC Act permits a banking entity to acquire or retain an ownership interest in, or have certain relationships with, a covered fund notwithstanding the restrictions on investments in, and relationships with, a covered fund, if: (i) Such activity or investment is conducted by a banking entity pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; (ii) the activity occurs solely outside of the United States; (iii) no ownership interest in such fund is offered for sale or sold to a resident of the United States; and (iv) the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States. *See* 12 U.S.C. 1851(d)(1)(I).

[596] *See* final rule § ■ ■.13(b)(4).

[597] *See, e.g.,* BPI; BVI; EBF; IIB; JBA; and New England Council.

[598] *See* EBF.

[599] *See* BPI.

[600] *See, e.g.,* Better Markets and CAP.

[601] *See* 12 U.S.C. 1851(d)(1)(I).

[602] *See* final rule § ■ ■.13(b)(1)(iii).

rule, like the proposal, also clarifies that if the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator, or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of the marketing restriction to participate in any offer or sale by the covered fund of ownership interests in the covered fund.[603] This revision adopts existing staff guidance addressing this issue.[604] Several commenters supported this clarification.[605] Some commenters argued that this clarification appropriately excludes from the marketing restriction those activities where the risk occurs and remains outside of the United States and reflects the intended extraterritorial limitations of the section 13 of the BHC Act.[606] In addition, commenters stated that codifying the previously issued staff guidance will provide greater clarity and certainty for non-U.S. banking entities making investments in third party funds (*i.e.,* covered funds that the banking entity does not advise or organize and offer pursuant to § ▮▮.11(a) or (b) of the final rule) and will enable long-term strategies in reliance on this provision.[607]

The agencies are adopting this clarification as proposed to formally incorporate the existing staff guidance. As staff noted in the previous staff guidance, the marketing restriction constrains the foreign banking entity in connection with its own activities with respect to covered funds rather than the activities of unaffiliated third parties.[608] This ensures that the foreign banking entity seeking to rely on the foreign fund exemption does not engage in an offering of ownership interests that targets residents of the United States. This clarification limits 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. 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 foreign fund exemption may not be available in certain circumstances even though the risks and activities of a foreign banking entity with respect to its investment in the covered fund are solely outside the United States.

One commenter asked the agencies to clarify that the requirement that the banking entity (including the relevant personnel) that makes the decision ''to acquire or retain the ownership interest or act as sponsor to the covered fund'' must not be located in the United States does not prohibit non-U.S. investment funds from utilizing the expertise of U.S. investment advisers under delegation agreements.[609] This commenter noted that a foreign investment fund may appoint a qualified U.S. investment adviser for providing investment management or investment advisory services under delegation but that the ultimate responsibility for the investment decisions and compliance with statutory and contractual investment limits remains with the foreign management company that manages the foreign investment fund. As stated in the preamble to the 2013 rule, the foreign fund exemption permits the U.S. personnel and operations of a foreign banking entity to act as investment adviser to a covered fund in certain circumstances. For example, the U.S. personnel of a foreign banking entity may provide investment advice and recommend investment selections to the manager or general partner of a covered fund so long as the investment advisory activity in the United States does not result in U.S. personnel participating in the control of the covered fund or offering or selling an ownership interest to a resident of the United States.[610] Consistent with the foreign trading exemption, as discussed above,[611] the agencies also are confirming that under the final rule, the foreign fund 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 agencies intend to address and request further comment on additional covered fund issues in a future proposed rulemaking.

4. Section ▮▮.14: Limitations on Relationships With a Covered Fund

a. Relationships With a Covered Fund

Section 13(f) of the BHC Act provides that, with limited exceptions, no banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund, or that organizes and offers a hedge fund or private equity fund pursuant to section 13(d)(1)(G), and no affiliate of such entity, may enter into a transaction with the fund, or with any other hedge fund or private equity fund that is controlled by such fund, that would be a ''covered transaction,'' as defined in section 23A of the Federal Reserve Act, as if such banking entity and the affiliate thereof were a member bank and the hedge fund or private equity fund were an affiliate thereof.[612] The 2013 rule includes this prohibition as well.[613] The proposal included a request for comment regarding the restrictions in section 13(f) of the BHC Act and § ▮▮.14 of the 2013 rule. As with the other covered fund issues for which no specific rule text was proposed, the agencies continue to consider the prohibition in section 13(f) of the BHC Act and intend to issue a separate proposed rulemaking that addresses this issue.

b. Prime Brokerage Transactions Section

13(f) of the BHC Act provides an exemption from the prohibition on covered transactions with a hedge fund or private equity fund for any prime brokerage transaction with a hedge fund or private equity fund in which a hedge fund or private equity fund managed, sponsored, or advised by a banking entity has taken an ownership interest (a second-tier fund).[614] The statute by its terms permits a banking entity with a relationship to a hedge fund or private equity fund described in section 13(f) of the BHC Act to engage in prime brokerage transactions (that are covered transactions) only with second-tier funds and does not extend to hedge funds or private equity funds more generally.[615] Under the statute, the exemption for prime brokerage transactions is available only so long as certain enumerated conditions are satisfied.[616] The 2013 rule included this exemption as well and similarly required satisfaction of certain enumerated conditions in order for a banking entity to engage in permissible prime brokerage transactions.[617] The

[603] *See* proposal § ▮▮.13(b)(3).

[604] *See supra* note 59, FAQ 13.

[605] *See, e.g.,* AIC; BPI; BVI; IIB; and EBF.

[606] *See, e.g.,* EBF and IIB.

[607] *See, e.g.,* AIC; BPI; and BVI.

[608] *See supra* note 59, FAQ 13.

[609] *See* BVI.

[610] 79 FR at 5741.

[611] *See supra* Part IV.B.4.

[612] *See* U.S.C. 1851(f)(1).

[613] *See* final rule § ▮▮.14(a)(1).

[614] *See* U.S.C. 1851(f)(3).

[615] Neither the statute nor the proposal limits covered transactions between a banking entity and a covered fund for which the banking entity does not serve as investment manager, investment adviser, or sponsor (as defined in section 13 of the BHC Act) or have an interest in reliance on section 13(d)(1)(G) of the BHC Act. Similarly, the final rule does not limit such covered transactions.

[616] *See* 12 U.S.C. 1851(f)(3).

[617] *See* final rule § ▮▮.14(a)(2)(ii).

2013 rule's conditions are that (i) the banking entity is in compliance with each of the limitations set forth in § __.11 of the 2013 rule with respect to a covered fund organized and offered by the banking entity or any of its affiliates; (ii) the CEO (or equivalent officer) of the banking entity certifies 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; and (iii) the Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

The proposal retained each of the 2013 rule's conditions for the prime brokerage exemption described above, including the requirement that certification be made to the appropriate agency for the banking entity.[618] Staffs of the agencies previously issued guidance explaining when a banking entity was required to provide this certification during the conformance period.[619] The proposal incorporated this guidance into the rule text by requiring banking entities to provide the CEO certification annually no later than March 31 of the relevant year.[620] This change was intended to provide banking entities with certainty about when the required certification must be provided to the appropriate agency in order to comply with the prime brokerage exemption. As under the 2013 rule, under the proposal, the CEO would have 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.[621]

One commenter recommended that the agencies expressly state that the CEO certification for purposes of the prime brokerage exemption is based on a reasonable review by the CEO and is made based on the knowledge and reasonable belief of the CEO.[622] That commenter also requested that the agencies clarify that the term ''prime brokerage transaction'' includes transactions and services commonly provided in connection with prime brokerage transactions, as described under the 2013 rule, including: (1) Lending and borrowing of financial assets, (2) provision of secured financing collateralized by financial assets, (3) repurchase and reverse repurchase of financial assets, (4) derivatives, (5) clearance and settlement of transactions, (6) ''give-up'' agreements, and (7) purchase and sale of financial assets from inventory.[623] Similarly, another commenter requested that the agencies clarify that the term ''prime brokerage transaction'' applies to any transaction provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, or data, operational, and administrative support regardless of which business line within the banking entity conducts the business.[624] The same commenter suggested that any prime brokerage transaction with a second-tier covered fund should be presumed to comply with section __.14 of the rule and the prime brokerage exemption as long as it is executed in compliance with the requirements of Section 23B of the Federal Reserve Act.[625] In addition, one commenter recommended limiting the prime brokerage exemption by, for instance, excluding financing and securities lending and borrowing from the prime brokerage exemption.[626]

The final rule adopts the proposed revision to the prime brokerage exemption with no changes. The agencies believe that codifying a deadline for CEO certification with respect to prime brokerage transactions will provide banking entities with greater certainty and facilitate supervision and review of the prime brokerage exemption. With respect to the other issues raised by commenters regarding the prime brokerage exemption in section 13(f) of the BHC Act, the agencies continue to consider these issues and intend to issue a separate proposed rulemaking that specifically addresses these issues.

D. Subpart D – Compliance Program Requirement; Violations

1. Section __.20: Program for Compliance; Reporting

Section __.20 of the 2013 rule contains compliance program and metrics collection and reporting requirements. The 2013 rule was intended to focus the most significant compliance obligations on the largest and most complex organizations, while minimizing the economic impact on small banking entities.[627] To this end, the 2013 rule included a simplified compliance program for small banking entities and banking entities that did not engage in extensive trading activity.[628] However, as the agencies noted in the proposal, public feedback has indicated that even determining whether a banking entity is eligible for the simplified compliance program could require significant analysis for small banking entities. In addition, certain traditional banking activities of small banks fall within the scope of the proprietary trading and covered fund prohibitions and exemptions, making banks engaging in these activities ineligible for the simplified compliance program. As the agencies noted in the proposal, public feedback has also indicated that the compliance program requirements are unduly burdensome for larger banking entities that must implement the rule's enhanced compliance program, metrics, and CEO attestation requirements. Accordingly, the agencies proposed to revise the compliance program requirements to allow greater flexibility for banking entities in integrating the Volcker compliance and exemption requirements into existing compliance programs and to focus the requirements on the banking entities with the most significant and complex activities.

Specifically, the agencies proposed applying the compliance program requirement to banking entities as follows:

- Banking entities with significant trading assets and liabilities. Banking entities with significant trading assets and liabilities would have been subject to the six-pillar compliance program requirement (§ __.20(b) of the 2013 rule), the metrics reporting requirements (§ __.20(d) of the 2013 rule),[629] the covered fund documentation requirements (§ __.20(e) of the 2013 rule), and the CEO attestation

[618] *See* 83 FR at 33486–87.

[619] *See supra* note 59, FAQ 18.

[620] *See* 83 FR at 33487.

[621] This duty to update the certification is required as a condition of the statutory exemption. *See* 12 U.S.C. 1851(f)(3)(A)(ii).

[622] *See* SIFMA.

[623] *See id.*

[624] *See* ABA.

[625] *See id.*

[626] *See* Occupy the SEC.

[627] *See* 79 FR 5753.

[628] Banking entities did not have any compliance program obligations under the 2013 rule if they do not engage in any covered activities other than trading in certain government, agency, State or municipal obligations. § __20(f)(1). Additionally, banking entities with $10 billion or less in total consolidated assets could satisfy the compliance program requirements under the 2013 rule by including appropriate references to the requirements of section 13 of the BHC Act and the implementing regulations in their existing policies and procedures. § __.20(f)(2).

[629] As discussed below, the proposal would have amended the Appendix A metrics requirements to reduce compliance-related inefficiencies while allowing for the collection of data to permit the agencies to better monitor compliance with section 13 of the BHC Act. In addition, the proposal would have eliminated Appendix B of the 2013 rule, which would have resulted in Appendix A being re-designated as the ''Appendix.''

requirement (Appendix B of the 2013 rule).[630]

- Banking entities with moderate trading assets and liabilities. Banking entities with moderate trading assets and liabilities would have been required to establish the simplified compliance program (described in § ▮▮.20(f)(2) of the 2013 rule) and comply with the CEO attestation requirement.
- Banking entities with limited trading assets and liabilities. Banking entities with limited trading assets and liabilities would have been presumed to be in compliance with the proposal and would have had no obligation to demonstrate compliance with subpart B and subpart C of the implementing regulations on an ongoing basis. These banking entities would not have been required to demonstrate compliance with the rule unless and until the appropriate agency, based upon a review of the banking entity's activities, determined that the banking entity should have been treated as if it did not have limited trading assets and liabilities.

After reviewing all of the comments to this section, the agencies are finalizing these changes largely as proposed, except for further tailoring application of the CEO attestation requirement to only banking entities with significant trading assets and liabilities and revising the notice and response procedures in subpart D to be more broadly applicable.

a. Compliance Program Requirements for Banking Entities With Significant Trading Assets and Liabilities

i. Section 20(b)—Six-Pillar Compliance Program

Section ▮▮.20(b) of the 2013 rule specifies six elements that each compliance program required under that section must at a minimum contain.

The six elements specified in § ▮▮.20(b) are:

- Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities and covered fund activities and investments conducted by the banking entity to ensure that all activities and investments that are subject to section 13 of the BHC Act and the rule comply with section 13 of the BHC Act and the 2013 rule;
- A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and the rule and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and the 2013 rule;
- A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and the 2013 rule and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in the rule or by management as requiring attention;
- Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;
- Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and
- Records sufficient to demonstrate compliance with section 13 of the BHC Act and the 2013 rule, which a banking entity must promptly provide to the relevant agency upon request and retain for a period of no less than 5 years.

Under the 2013 rule, these six elements have to be part of the required compliance program of each banking entity with total consolidated assets greater than $10 billion that engages in covered trading activities and investments subject to section 13 of the BHC Act and the implementing regulations (excluding trading permitted under § ▮▮.6(a) of the 2013 rule).

The agencies proposed further tailoring the compliance program requirements to make the scale of compliance activity required by the rule commensurate with a banking entity's size and level of trading activity. Specifically, the proposal would have applied the six-pillar compliance program requirements to banking entities with significant trading assets and liabilities and would have afforded flexibility to integrate the § ▮▮.20 compliance program requirements into other compliance programs of the banking entity. The proposal also would have eliminated the enhanced compliance program requirements found in Appendix B of the 2013 rule,[631] except for the CEO attestation requirement discussed below. The proposal also would have revised the covered fund documentation requirements in § ▮▮.20(e), which applied to all banking entities with greater than $10 billion in total consolidated assets under the 2013 rule, to only apply to firms with significant trading assets and liabilities.

Several commenters expressed support for the elimination of the enhanced compliance program requirements in Appendix B of the 2013 rule.[632] One commenter requested that the agencies provide greater discretion to banking entities with significant trading assets and liabilities to tailor their compliance programs to the size and complexity of their activities and structure of their business.[633] A few commenters opposed the elimination of Appendix B of the 2013 rule.[634] One asserted that firms have already made investments in their compliance programs, so there was no justification for the change.[635] Another commenter argued that the remaining controls are not sufficient to ensure compliance with the rule because they lack specificity.[636] This commenter also asserted that merging the Volcker Rule requirements with the safety and soundness compliance framework would be problematic as the Volcker Rule considers market supply and demand dynamics while the safety and soundness compliance framework generally only considers risks.[637] The concern was that a combined program might not adequately consider the activities restrictions of the Volcker Rule.

The agencies are adopting the six-pillar compliance program requirements and retaining the covered fund

[630] Although the proposal would have eliminated Appendix B, as noted above, it would have continued to apply a modified version of the CEO attestation to banking entities without limited trading assets and liabilities.

[631] The enhanced minimum standards in Appendix B of the 2013 rule required that the firm's compliance program: (1) Be reasonably designed to identify, document, monitor, and report the trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and the 2013 rule; (2) establish and enforce appropriate limits on the activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and the 2013 rule; (3) subject the effectiveness of the compliance program to periodic independent review and testing, and ensure that the entity's internal audit, corporate compliance and internal control functions involved in review and testing are effective and independent; (4) make senior management, and others as appropriate, accountable for the effective implementation of the compliance program, and ensure that the board of directors and CEO (or equivalent) of the banking entity review the effectiveness of the compliance program; and (5) facilitate supervision and examination by the agencies of the banking entity's trading and covered fund activities and investments.

[632] *See, e.g.,* Insurance Coalition; Real Estate Associations; CREFC; Credit Suisse; JBA; FSF; and ABA.

[633] *See* Credit Suisse.

[634] *See, e.g.,* Bean; Data Boiler; and AFR.

[635] *See* Bean.

[636] *See* AFR.

[637] *Id.*

documentation requirements for banking entities with significant trading assets and liabilities as proposed. The agencies continue to believe that these banking entities are engaged in activities at a scale that warrants the costs of establishing and maintaining the detailed and comprehensive compliance program elements described in §§ ■ ■.20(b) and ■ ■.20(e) of the rule. Accordingly, the agencies believe it is appropriate to require banking entities with significant trading assets and liabilities to maintain a six-pillar compliance program to ensure that banking entities' activities are conducted in compliance with section 13 of the BHC Act and the implementing regulations. Based on experience with the six-pillar compliance program requirements under the 2013 rule, the agencies believe that such requirements are appropriate and effective for firms with significant trading assets and liabilities; these standards impose certain minimum standards, but permit the banking entity flexibility to reasonably design the program in light of the banking entity's activities. The agencies also believe that the prescribed six-pillar compliance requirements are consistent with the standards banking entities use in their traditional risk management and compliance processes.

The agencies believe that banking entities should have discretion to tailor their compliance programs to the structure and activities of their organizations. The flexibility to build on compliance programs that already exist at banking entities, including internal limits, risk management systems, board-level governance protocols, and the level at which compliance is monitored, may reduce the costs and complexity of compliance while also enabling a robust compliance mechanism for the final rule.

The agencies therefore believe that removal of the specific, enhanced minimum standards in Appendix B will afford a banking entity considerable flexibility to satisfy the elements of § ■ ■.20 in a manner that it determines to be most appropriate given its existing compliance regimes, organizational structure, and activities. Allowing banking entities the flexibility to integrate Volcker Rule compliance requirements into existing compliance programs should increase the effectiveness of the § ■ ■.20 requirements by eliminating duplicative governance and oversight structures arising from the Appendix B requirement for a stand-alone compliance program.

ii. CEO Attestation Requirement

The 2013 rule included a requirement in its Appendix B that a banking entity's CEO must review and annually attest in writing to the appropriate agency that the banking entity has in place processes to establish, maintain, enforce, review, test, and modify the compliance program established pursuant to Appendix B and § ■ ■.20 of the 2013 rule in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and the implementing regulations.

Under the proposal, Appendix B would have been eliminated, and a modified CEO attestation requirement would have applied to banking entities with significant trading assets and liabilities or moderate trading assets and liabilities. The agencies believed that, while the revisions to the compliance program requirements under the proposal generally would simplify the compliance program requirements, this simplification should be balanced against the requirement for all banking entities to maintain compliance with section 13 of the BHC Act and the implementing regulations. Accordingly, the agencies believed that applying the CEO attestation requirement to banking entities with meaningful trading activities would ensure that the compliance programs established by these banking entities pursuant to § ■ ■.20(b) or § ■ ■.20(f)(2) of the proposal would be reasonably designed to achieve compliance with section 13 of the BHC Act and the implementing regulations as proposed. The agencies proposed limiting the CEO attestation requirement to banking entities with moderate trading assets and liabilities or significant trading assets and liabilities because, under the proposal, banking entities with limited trading assets and liabilities would have been subject to a rebuttable presumption of compliance. Thus, the agencies did not believe it necessary to require a CEO attestation for banking entities with limited trading assets and liabilities as those banking entities would not be subject to the express requirement to maintain a compliance program pursuant to § ■ ■.20 under the proposal. Further, the agencies proposed retaining the 2013 rule's language concerning how the CEO attestation requirement applies to the U.S. operations of a foreign banking entity. This language states that, in the case of the U.S. operations of a foreign banking entity, including a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States.

Several commenters expressed support for the CEO attestation requirement and recommended that the agencies make no changes to the requirement or apply it to all banking entities.[638] Other commenters believed that the CEO attestation requirement should not apply to banking entities with moderate trading assets and liabilities,[639] as requiring the development of costly and burdensome internal compliance efforts would not be consistent with the activities or risks of such firms.[640] One commenter argued that the CEO attestation requirement duplicates existing quarterly reporting process,[641] and another commenter asserted that imposing such a requirement for firms with moderate trading assets and liabilities would negate the tailoring the agencies proposed for those banking entities.[642] One commenter urged the agencies to limit the application of the compliance program and reporting requirements to only the U.S. operations of foreign banking entities.[643] Other requests for modification included streamlining the CEO attestation requirement,[644] adding a knowledge qualifier,[645] and limiting the scope to only U.S. operations.[646] A few commenters requested that the CEO attestation be completely eliminated.[647]

After reviewing the comments, the agencies have decided to retain the CEO attestation requirement but only for banking entities with significant trading assets and liabilities. The agencies continue to believe that incorporating the CEO attestation requirement (which was previously in Appendix B of the 2013 rule) into § ■ ■.20(c) will help to ensure that the compliance program established pursuant to that section is reasonably designed to achieve compliance with section 13 of the BHC Act and the implementing regulations.

However, the agencies have decided not to apply the CEO attestation requirement to banking entities without significant trading assets and liabilities. Such banking entities will still need to comply with section 13 of the BHC Act and the implementing regulations;

[638] *See, e.g.,* AFR; Merkley; Better Markets; and Data Boiler.

[639] *See, e.g.,* Capital One et al.; ABA; Arvest; BB&T; State Street; BPI; and IIB.

[640] *See* Capital One et al.

[641] *See* BOK.

[642] *See* Capital One et al.

[643] *See* IIB.

[644] *See, e.g.,* ABA and JBA.

[645] *See, e.g.,* ABA and FSF.

[646] *See* JBA.

[647] *See* BOK and Capital One et al.

however, they will not need to provide CEO attestations. This means that the CEO attestation requirement will not be expanded to cover banking entities that did not need to provide CEO attestations under the 2013 rule.[648] The agencies believe that requiring a CEO attestation from banking entities with limited or moderate trading assets and liabilities would result in additional costs and burdens that would not be commensurate with the type of activities or risks of these firms.

b. Compliance Program Requirements for Banking Entities With Moderate Trading Assets and Liabilities

The 2013 rule provided that a banking entity with total consolidated assets of $10 billion or less as measured on December 31 of the previous two years that engages in covered activities or investments pursuant to subpart B or subpart C of the 2013 rule (other than trading activities permitted under § ■■.6(a) of the 2013 rule) may satisfy the compliance program requirements by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and subpart D of the implementing regulations and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.[649]

The agencies proposed extending the availability of this simplified compliance program to banking entities with moderate trading assets and liabilities. The agencies believed that streamlining the compliance program requirements for banking entities with moderate trading assets and liabilities would be appropriate because the scale and nature of the activities and investments in which these banking entities are engaged may not justify the additional costs associated with establishing the compliance program elements under §§ ■■.20(b) and (e) of the 2013 rule. Such activities may be appropriately managed through an appropriately tailored simplified compliance program. The agencies noted that banking entities with moderate trading assets and liabilities would be able to incorporate their simplified compliance program into existing compliance policies and procedures and tailor their compliance programs to the size and nature of their activities, consistent with the approach for banking entities with significant trading assets and liabilities.

Other commenters expressed support for a tailored compliance program for banking entities with moderate trading assets and liabilities.[650] The agencies are adopting the compliance program requirements, as proposed, for banking entities with moderate trading assets and liabilities, for the aforementioned reasons. Thus, a banking entity with moderate trading assets and liabilities qualifies for the simplified compliance program under § ■■.20(f)(2) of the final rule.

c. Compliance Program Requirements for Banking Entities With Limited Trading Assets and Liabilities

Under the proposal, a banking entity with limited trading assets and liabilities would have been presumed to be in compliance with the rule. Banking entities with limited trading assets and liabilities would have had no obligation to demonstrate compliance with subpart B and subpart C of the implementing regulations on an ongoing basis, given the limited scale of their trading operations. The agencies believed, based on experience implementing and supervising compliance with the 2013 rule, that these banking entities generally engage in minimal trading and investment activities subject to section 13 of the BHC Act. Thus, the agencies believed that the limited trading assets and liabilities of the banking entities qualifying for the presumption of compliance would be unlikely to warrant the costs of establishing a compliance program under § ■■.20 of the 2013 rule.

Under the proposed approach, the agencies would not have expected a banking entity with limited trading assets and liabilities that qualified for the presumption of compliance to demonstrate compliance with the proposal on an ongoing basis in conjunction with the agencies' normal supervisory and examination processes. However, the appropriate agency would have been able to exercise its authority to treat the banking entity as if it did not have limited trading assets and liabilities if, upon review of the banking entity's activities, the relevant agency determined that the banking entity engaged in proprietary trading or covered fund activities that were otherwise prohibited under subpart B or subpart C. A banking entity would have been expected to remediate any impermissible activity upon being notified of such determination by the agency within a period of time deemed appropriate by the agency.

In addition, irrespective of whether a banking entity had engaged in activities in violation of subpart B or C, the relevant agency would have retained its authority to require a banking entity to apply the compliance program requirements that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the relevant agency determined that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion, did not warrant a presumption of compliance.

One commenter expressed support for the rebuttable presumption of compliance for banking entities with limited trading assets and liabilities.[651] Another commenter suggested completely exempting banking entities with limited trading assets and liabilities from section 13 of the BHC Act.[652] One commenter requested that the evidence that an agency would require in response to its attempt to rebut a presumption should not be greater than what is required of the banking entity under the presumption.[653] Another commenter recommended that the agencies treat inadvertent violations of the rule as supervisory matters and not as violations.[654]

The final rule adopts the compliance program requirements for banking entities with limited trading assets and liabilities as proposed. The agencies note that the removal of the standard compliance program requirements in § ■■.20 for banking entities with limited trading assets and liabilities does not relieve those banking entities of the 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, including RENTD requirements for permitted underwriting and market making, under the final rule. The agencies believe the presumption of compliance for banking entities with limited trading assets and liabilities will allow flexibility for these banking entities to take appropriate actions, tailored to the individual activities in which the banking entities engage, to comply with the rule. Such

[648] The 2013 rule applied the CEO attestation requirement to all banking entities with total consolidated assets of $50 billion or more (or, in the case of a foreign banking entity, total U.S. assets of $50 billion or more). By applying the CEO attestation requirement to banking entities with moderate trading assets and liabilities, the proposal would have expanded its applicability to certain banking entities with less than $50 billion in total U.S. assets that were not subject to the requirement under the 2013 rule.

[649] 2013 rule § ■■.20(f)(2).

[650] *See, e.g.,* BB&T and JBA.

[651] *See* B&F.

[652] *See* JBA.

[653] *See* SIFMA.

[654] *See* ABA.

actions may include, for example, integrating the requirements for permitted trading activities under the exemptions in § __.4, __.5, and __.6 into existing internal policies and procedures (to the extent the banking entity engages in such activities), or taking other steps to satisfy the criteria to engage in such activities under the final rule. Regarding one commenter's proposal that the agencies completely exempt banking entities with limited trading activities, the agencies note that section 13 of the BHC Act does not give the agencies authority to completely exempt banking entities from the requirements of the Volcker Rule.

d. Notice and Response Procedures

The proposed rule included notice and response procedures that an agency would follow when determining whether to treat a banking entity with limited trading assets and liabilities as if it did not have limited trading assets and liabilities.[655] The notice and response procedures required the relevant agency to provide a written explanation of its determination and allowed the banking entity the opportunity to respond to the agency with any matters that the banking entity would have the agency consider in reaching its determination. The response procedures would have required the banking entity to respond within 30 days unless the agency extended the time period for good cause or if the agency shortened the time period either with the consent of the banking entity or because the conditions or activities of the banking entity so required. Failure to respond within the applicable timeframe would have constituted a waiver of objection to the agency's determination. After the close of the response period, the agency would have decided, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the agency's determination and would have notified the banking entity of its decision in writing. These notice and response procedures were similar, but not identical to, notice and response procedures found elsewhere in the proposed rule.[656]

One commenter suggested that there should be a consistent notice and response process regarding all presumptions in the final rule.[657] The agencies agree and have modified the notice and response procedures in subpart D to apply more broadly to several types of determinations under the final rule, including determinations and rebuttals made under §§ __.3, __.4, and __.20.[658] This change will provide consistency and enhance transparency with respect to the processes that an agency will follow for certain determinations throughout the final rule.

E. Subpart E—Metrics: Appendix to Part [•]—Reporting and Recordkeeping Requirements

Under the 2013 rule, a banking entity with substantial trading activity [659] must furnish the following quantitative measurements for each of its trading desks engaged in covered trading activity, calculated in accordance with Appendix A:

- Risk and position limits and usage;
- Risk factor sensitivities;
- Value-at-risk and stressed VaR;
- Comprehensive profit and loss attribution;
- Inventory turnover;
- Inventory aging; and
- Customer-facing trade ratio.

The proposal explained that, based on the agencies' evaluation of the effectiveness of the metrics data in monitoring covered trading activities for compliance with section 13 of the BHC Act and the associated reporting costs,[660] the proposed rule would have amended Appendix A requirements to reduce compliance-related inefficiencies while allowing for the collection of data to permit the agencies to better monitor compliance with section 13 of the BHC Act.[661] Specifically, the proposed rule would have made the following modifications to the reporting requirements in Appendix A:

- Limit the applicability of certain metrics only to market making and underwriting desks.
- Replace the Customer-Facing Trade Ratio with a new Transaction Volumes metric to more precisely cover types of trading desk transactions with counterparties.
- Replace Inventory Turnover with a new Positions metric, which measures the value of all securities and derivatives positions.
- Remove the requirement to separately report values that can be easily calculated from other reported quantitative measurements.
- Streamline and make consistent value calculations for different product types, using both notional value and market value to facilitate better comparison of metrics across trading desks and banking entities.
- Eliminate inventory aging data for derivatives because aging, as applied to derivatives, does not appear to provide a meaningful indicator of potential impermissible trading activity or excessive risk-taking.
- Require banking entities to provide qualitative information specifying for each trading desk the types of financial instruments traded, the types of covered trading activity the desk conducts, and the legal entities into which the trading desk books trades.
- Require a Narrative Statement describing changes in calculation methods, trading desk structure, or trading desk strategies.
- Remove the paragraphs labeled ''General Calculation Guidance'' from the regulation. The Instructions generally would provide calculation guidance.[662]
- Remove the requirement that banking entities establish and report limits on Stressed Value-at-Risk at the trading desk-level because trading desks do not typically use such limits to manage and control risk-taking.
- Require banking entities to provide descriptive information about their reported metrics, including information uniquely identifying and describing

[655] *See* proposed rule § __.20(g)(2)(ii).

[656] *See* proposed rule §§ __.3(c), __.3(g)(2), __.4(a)(8)(iv), __.4(b)(6)(iv).

[657] *See* IIB.

[658] *See* final rule § __.20(i).

[659] Appendix A of the 2013 rule applies to U.S. banking entities with trading assets and liabilities the average gross sum of which equals or exceeds $10 billion on a worldwide consolidated basis over the previous four calendar quarters (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States), and to foreign banking entities with combined U.S. trading assets and liabilities the average gross sum of which equals or exceeds $10 billion over the previous four calendar quarters (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States). 2013 rule § __.20(d)(1).

[660] *See* 79 FR at 5772.

[661] As previously noted in the section entitled ''Enhanced Minimum Standards for Compliance Programs,'' the Agencies are proposing to eliminate Appendix B of the 2013 rule. Current Appendix A is therefore re-designated as the ''Appendix'' in the final rule.

[662] The Instructions will be available on each agency's respective website at the addresses specified in the Paperwork Reduction Act section of this SUPPLEMENTARY INFORMATION. For the SEC and CFTC, this document represents the views of SEC staff and CFTC staff; neither Commission has approved nor disapproved them. The Instructions are not a rule, regulation, or statement of the SEC or the CFTC; and like all SEC or CFTC staff guidance, it has no legal force or effect, does not alter or amend applicable law, and creates no new or additional SEC or CFTC obligations for any person. Consistent with changes elsewhere in the final rule and with the Federal banking agencies' Interagency Statement Clarifying the Role of Supervisory Guidance (Sept. 11, 2018; *https://www.federalreserve.gov/supervisionreg/srletters/sr1805.htm, https://www.occ.gov/news-issuances/news-releases/2018/nr-ia-2018-97a.pdf, https://www.fdic.gov/news/news/financial/2018/fil18049.html*), the agencies are removing references to guidance and expectations from the regulatory text of the metrics reporting requirements.

certain risk measurements and information identifying the relationships of these measurements within a trading desk and across trading desks.

• Require electronic submission of the Trading Desk Information, Quantitative Measurements Identifying Information, and each applicable quantitative measurement in accordance with the XML Schema specified and published on each agency's website.[663]

Several commenters objected to the proposed rule's modification of the metrics. Some commenters suggested that the proposed amendments to metrics reporting were inappropriate in light of the lack of public disclosure of previously reported metrics information, and in some cases recommended that the agencies expand metrics reporting requirements.[664] Other commenters recommended that the agencies simplify or eliminate the metrics.[665] As described in detail below, the final rule streamlines the reporting requirements in Appendix A of the 2013 rule and adopts a limited set of the new requirements introduced in the proposal. Among other changes, the final rule entirely eliminates the stressed value-at-risk, risk factor sensitivities, and inventory aging. Taken together, the agencies estimate that the revised metrics in the final rule would result in a 67 percent reduction in the number of data items and approximately 94 percent reduction in the total volume of data, relative to the 2013 rule's reporting requirement. The agencies believe the remaining metrics are generally useful to help firms demonstrate that their covered trading activities are conducted appropriately, and to enable the agencies to identify activities that potentially involve impermissible proprietary trading. Moreover, the agencies believe that these items do not pose a special calculation burden because firms generally already record these values in the regular course of business. The agencies expect that the changes in the final rule will enable banking entities to leverage calculations from their market risk capital programs to meet the requirements for the Volcker Rule quantitative measurements, which will reduce complexity and cost for banking entities, and improve the effectiveness of the final rule.[666] As discussed above, in order to give banking entities a sufficient amount of time to comply with the changes adopted, banking entities will not be required to comply with the final amendments until January 1, 2021 (although banking entities may voluntarily comply, in whole or in part, with the amendments adopted in this release prior to the compliance date, subject to the agencies' completion of necessary technological changes). By providing an extended compliance period, the final amendments also should facilitate firms in integrating these requirements into existing or planned compliance programs.

1. Purpose

Paragraph I.c of Appendix A of the 2013 rule provides that the quantitative measurements that are required to be reported under the rule are not intended to serve as a dispositive tool for identifying permissible or impermissible activities. The proposal would have expanded the qualifying language in paragraph I.c of Appendix A to apply to all of the information required to be reported pursuant to the appendix, rather than only to the quantitative measurements themselves. In addition, the proposed rule would have also removed paragraph I.d. in Appendix A of the 2013 rule, which provides that the agencies would review the metrics data and revise the metrics collection requirements based on that review.

The agencies received no comments on these proposed changes. The final rule adopts the changes, as proposed. The agencies believe that the trading desk information and quantitative measurements identifying information, coupled with the quantitative measurements, should assist the agencies in monitoring compliance. This information will be used to monitor patterns and identify activity that may warrant further review. Additionally, the final rule removes paragraph I.d. Appendix A of the 2013 rule, as the agencies have conducted this preliminary evaluation of the effectiveness of the quantitative measurements collected to date and have adopted modifications based on that review.

2. Definitions

The proposed rule would have clarified the definition of "covered trading activity" by adding the phrase "in its covered trading activity" to clarify that the term "covered trading activity," as used in the proposed appendix, may include trading conducted under § __.3(d), __.6(c), __.6(d), or __.6(e) of the proposal.[667] In addition, the proposed rule defined two additional terms for purposes of the appendix, "applicability" and "trading day," that were not defined in the 2013 rule. The proposal defined "applicability" to clarify when certain metrics are required to be reported for specific trading desks and thus make several metrics applicable only to desks engaged in market making or underwriting. Finally, the proposal defined "trading day," a term used throughout Appendix A of the 2013 rule,[668] to mean a calendar day on which a trading desk is open for trading.

Commenters supported the proposal to define "applicability" in order to clarify that certain metrics are only applicable to desks engaged in market making or underwriting.[669] One commenter suggested defining the scope of "covered trading activity" to align with activity covered under the Basel Committee's revised standard for market risk capital.[670] While the agencies received no comments on the proposed definition of "trading day" in the regulation, several comments expressed serious concerns with the proposed "trading day" definition in the 2018 Instructions,[671] specifically requiring banking entities to report metrics for trading days when U.S. markets are closed but non-U.S. locations may be open.[672] These commenters argued that this would impose significant operational costs with no commensurate benefit to the agencies' oversight ability. However, the Agencies feel the definition of trading day is appropriate because the potential for impermissible

[663] The staff-level Technical Specifications Guidance describes the XML Schema. The Technical Specifications Guidance and the XML Schema are available on each agency's respective website at the addresses specified in the Paperwork Reduction Act section of this **SUPPLEMENTARY INFORMATION**.

[664] *See, e.g.,* AFR; Better Markets; Occupy the SEC; Public Citizen; and Volcker Alliance.

[665] *See, e.g.,* ABA; FSF; IIB; New England Council; and SIFMA.

[666] The agencies anticipate the market risk capital calculations and the Volcker Rule quantitative measurements will align particularly closely when the banking agencies adopt a rule implementing the Basel Committee's market risk capital standard in the United States. However, the agencies note that certain anticipated changes resulting from the Basel market risk capital standards may still result in a mismatch between metrics required under the market risk capital rule and the final rule. The agencies are aware of this potential issue and intend to address any such

[667] The proposed change would clarify that banking entities would have the discretion (but not the obligation) to report metrics with respect to a broader range of activities.

[668] Appendix A of the 2013 rule provides that the calculation period for each quantitative

~~discrepancies at a future date.~~

~~measurement is one trading day, but does~~
not
define ''trading day''.

[669] *See, e.g.,* Credit Suisse; FSF; and JBA.

[670] *See* JBA.

[671] The definition in the Instructions require banking entities to calculate each metric for each calendar day on which a trading desk is open for trading, even if the desk is closed for trading in one jurisdiction (for example, due to a national holiday).

[672] *See, e.g.,* ABA; CCMR; FSF; and SIFMA.

trading activity on a desk exists on any day when the desk is open for trading, regardless of which markets are open. The final rule retains the definition.

The agencies believe that the scope of "covered trading activity" in the final rule is appropriate, and note that, due to changes in the definition of trading account, the scope of "covered trading activity" will align more closely with the scope of activities covered under the Basel Committee's market risk capital standards for certain banking entities. Therefore, the final rule adopts these definitions as proposed.

3. Reporting and Recordkeeping

Paragraph III.a of Appendix A of the 2013 rule required banking entities subject to the appendix to furnish seven quantitative metrics for all trading desks engaged in trading activity conducted pursuant to § ■ ■.4, § ■ ■.5, or § ■ ■.6(a) (*i.e.,* permitted underwriting, market making, and risk-mitigating hedging activity and trading in certain government obligations).[673]

The proposal would have made several modifications to streamline the reporting requirements in paragraph III.a of Appendix A of the 2013 rule. Specifically, the proposal would have: (1) Replaced the Inventory Turnover and Customer-Facing Trade Ratio metrics with the Positions and Transaction Volumes quantitative measurements, respectively; (2) limited the Inventory Aging metric to only apply to securities [674] and changed the name of the quantitative measurement to the Securities Inventory Aging; (3) added the phrase "as applicable" to paragraph III.a in order to limit application of the Positions, Transaction Volumes, and Securities Inventory Aging quantitative measurements to only trading desks that rely on § ■ ■.4(a) or § ■ ■.4(b) to conduct underwriting activity or market making-related activity, respectively; and (4) inserted references in paragraph III.a to the new qualitative information requirements added to the appendix (*i.e.,* Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement requirements).[675]

A number of commenters supported the proposed changes to remove or tailor certain of the metrics provided in Appendix A of the 2013 rule, but opposed the addition of new metrics reporting requirements (*i.e.,* Trading Day definition, Trading Desk Information, Quantitative Measurements Identifying Information, Narrative Statement).[676] These commenters argued that, contrary to the proposal's objective to streamline compliance requirements, the new reporting requirements would significantly increase the overall compliance burden and impose substantial compliance costs on firms.[677] Three commenters argued that the agencies did not provide reasoned cost benefit analysis to justify the inclusion of the new metrics.[678] A few commenters recommended that the agencies should further streamline the current metrics to permit individual supervisors and banking entities to collaborate on determining which metrics are appropriate for that specific institution.[679] One commenter expressed concern that the agencies intended for the newly added metrics to replace onsite supervision and review, as the new qualitative information requirements often duplicate the existing compliance program requirements.[680]

Other commenters opposed all of the proposed revisions to the metrics, with certain limited exceptions (*e.g.,* limiting Inventory Aging to securities).[681] Some of these commenters argued that the agencies should adopt an approach focused on further streamlining the metrics requirements included in Appendix A of the 2013 rule.[682] A few of these commenters argued that the proposed changes to the existing metrics would in effect create entirely new metrics and that the new metrics would not provide new information that cannot be obtained through the existing metrics.[683] Other commenters supported only retaining the Comprehensive Profit and Loss Attribution and Risk Management metrics.[684] Another commenter supported retaining the current requirements, as any revisions would necessitate changes to firms' current systems and thus impose considerable operational burdens and costs.[685] One commenter stressed the inability of the general public to provide informed comment on the proposed changes as the agencies have not publically disclosed any data related to firms' metrics submissions.[686] Another commenter noted that disclosing firms' metrics submissions on an aggregated and/or time-delayed basis would enable the general public to understand the impact of the Volcker Rule.[687] In contrast, other commenters urged the agencies not to publicly disclose the metrics data because the data is confidential supervisory information that could be used by competitors and could create distortions in the capital markets.[688] Another commenter recommended replacing the metrics with a utility platform that would automate and perform trade surveillance in real time.[689]

As described in detail below, the final rule focuses on streamlining the 2013 rule's reporting requirements and only adopts a limited set of the new qualitative requirements introduced in the proposal. The agencies believe the remaining metrics are generally useful tools to help both firms and supervisors identify activities that potentially involve impermissible proprietary trading. Moreover, the agencies believe that these items do not pose a special calculation burden because firms already record these values in the regular course of business.

Finally, although the agencies are not including any changes related to public disclosure of the quantitative measurements in this final rule, the agencies will continue to consider whether some or all of the quantitative measurements should be publicly disclosed, taking into account the need to protect sensitive, confidential information, as well as restrictions on the agencies relating to the disclosure of sensitive, confidential business and supervisory information on a firm-specific basis.

4. Trading Desk Information

The proposed rule added a new paragraph III.b to Appendix A to require

[673] In addition, the 2013 rule permits banking entities to optionally include trading under § ■ ■.3(d), § ■ ■.6(c), § ■ ■.6(d), or § ■ ■.6(e).

[674] Including derivatives or securities that also meet the 2013 rule's definition of a derivative *See infra* Part III.E.2.*i*.v (discussing the Securities Inventory Aging quantitative measurement). The definition of "security" and "derivative" are set forth in § ■ ■.2 of the 2013 rule. *See* 2013 rule §§ ■ ■.2 (h), (y).

[675] In addition, the proposed rule would have added to paragraph III.a. a requirement that banking entities include file identifying information in each submission to the relevant agency pursuant to Appendix A of the 2013 rule. Specifically, the proposal would have required the file identifying information to include the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, the reporting period, and the creation date and time.

[676] *See, e.g.,* ABA; CCMR; Credit Suisse; FSF; and Goldman Sachs.

[677] *See, e.g.,* ABA; Credit Suisse; CCMR; and FSF.

[678] *See, e.g.,* CCMR; Public Citizen; and SIFMA.

[679] *See, e.g.,* Goldman Sachs; JBA; and States Street (on leveraging current industry practices for FX).

[680] *See* SIFMA.

[681] *See, e.g.,* Data Boiler; IIB; JBA; SIFMA; and State Street.

[682] *See, e.g.,* IIB; New England Council; SIFMA; and State Street.

[683] *See, e.g.,* IIB and SIFMA.

[684] *See, e.g.,* New England Council and State Street.

[685] *See* JBA.

[686] *See* Public Citizen.

[687] *See* AFR.

[688] *See, e.g.,* SIFMA and IIB.

[689] *See* Data Boiler.

banking entities to report certain descriptive information for each trading desk engaged in covered trading activity, including the trading desk name and identifier, the type of covered activity conducted by the desk, a brief description of the trading desk's general strategy (*i.e.,* the method for conducting authorized trading activities), the types of financial instruments purchased and sold by the trading desk, and the list of legal entities used to book trades including which were the main booking entities. The proposal also would have required firms to indicate for each trading desk whether each calendar date is a trading day or not a trading day and to specify the currency used by a trading desk as well as the conversion rate to U.S. dollars, if applicable.

In general, most commenters opposed requiring banking entities to report any new information outside the scope of the 2013 rule requirements, including qualitative information for each trading desk.[690] These commenters argued that the *de minimis* benefit to the agencies' oversight ability did not justify the significant operational costs associated with the new requirements, in particular identifying the legal entities used as booking entities by the trading desk as well as the financial instruments and other products traded by the desk.[691]

After considering these comments, the final rule retains a modified version of the Trading Desk Information. The final rule eliminates the requirement for each trading desk to identify the financial instruments and other products traded by the desk. The final rule also replaces the requirement to identify the legal entities that serve as booking entities for each trading desk with the simpler requirement that the banking entity's submission for each trading desk list: (1) Each agency receiving the submission for the desk; and (2) the exemptions or exclusions under which the desk conducts trading activity. The exemption/exclusion identification is particularly necessary in light of the fact that some of the quantitative measurements identified below (*i.e.,* the customer-facing activity measurements) are only required for desks operating under the underwriting or market making exemptions. The list of the agencies that have received the submission for a desk should facilitate inter-agency coordination, as generally trading desks encompass multiple legal entities, for which more than one agency may be the primary federal regulator. The agencies believe that this approach appropriately balances the benefit to the agencies and the cost to firms from the new reporting obligations.

5. Quantitative Measurements Identifying Information

The proposed rule added a new paragraph III.c. to Appendix A to require banking entities to prepare and provide five schedules: (i) Risk and Position Limits Information Schedule; (ii) Risk Factor Sensitivities Information Schedule; (iii) Risk Factor Attribution Information Schedule; (iv) Limit/Sensitivity Cross-Reference Schedule; and (v) Risk factor Sensitivity/Attribution Schedule. The proposed schedules would have provided descriptive information on the quantitative measurements on a collective basis for all relevant trading desks. The new proposed Schedules would have required banking entities to provide detailed information regarding each limit and risk factor sensitivity reported in quantitative measurements as well as on the attribution of existing position profit and loss to the risk factor reported in the quantitative measurements. In addition, the new Limit/Sensitivity Cross-Reference Schedule would have required banking entities to cross-reference, by unique identification label, a limit reported in the Risk and Position Limits Information Schedule to any associated risk factor sensitivity reported in the Risk Factor Sensitivities Information Schedule.

Many commenters generally opposed requiring banking entities to report any new information outside the scope of the 2013 rule requirements, including quantitative measurements identifying information.[692] One commenter argued that these new requirements impose undue costs on firms without providing any new supervisory benefit as they duplicate existing requirements in § ■■.20, which information the agencies can obtain through the normal supervisory and examination process.[693] This commenter further noted that increasing the scope of the appendix submission may harm the agencies' ability to effectively supervise Volcker compliance, by increasing the supervisory resources necessary to review the data at the detriment of performing normal supervision.

After considering these comments, the final rule retains a modified version of the Quantitative Measurements Identifying Information that eliminates the Risk Factor Sensitivities Information Schedule, the Limit/Sensitivity Cross-Reference Schedule and the Risk-Factor Sensitivity/Attribution Cross-Reference Schedule. Despite the potential benefit to the agencies from having a deeper understanding of the relationship between firms' limits and the risk factor sensitivities, the agencies agree that the proposed requirements could significantly increase firms' reporting burden in a way not commensurate with the potential benefits. The final rule retains the Risk Factor Attribution Information Schedule and a modified version of the Risk and Position Limits Information Schedule that includes identification of the corresponding risk factor attribution for certain limits (''Internal Limits Information Schedule''). While together these schedules add two new reporting elements relative to the 2013 Appendix A (*i.e.,* a description of the limit/risk factor sensitivities and risk factor attribution for certain limits), the agencies generally expect firms to realize a net reduction in reporting burden from the elimination of the duplicative reporting requirements in the current framework. The 2013 rule requires firms report internal limits, including but not limited to risk and position limits, and risk factor sensitivities established for each trading desk on a daily basis. As in practice, firms often use the same limits and risk factors for multiple desks, the 2013 rule results in firms reporting the same limit on a daily basis for multiple desks. These two new schedules reduce reporting burden by allowing firms to submit a comprehensive list of all the internal limits and the risk factor sensitivities that account for a preponderance of the profit or loss for the trading desks. Additionally, the final rule eliminates the requirement to report Risk Factor Sensitivities for each trading desk on a daily basis. Based on the submissions received to date, the agencies expect this change alone will reduce the total volume of data submitted by more than half relative to the 2013 rule.

6. Narrative Statement

The proposed rule would have added a new paragraph III.d. to require banking entities to submit a Narrative Statement in a separate electronic document to the relevant agency that describes any changes in calculation methods used for its quantitative measurements, or the trading desk structure (*e.g.,* adding, terminating, or merging pre-existing desks) or strategies. In addition, in its Narrative Statement, a banking entity, if applicable, would

[690] *See, e.g.,* ABA; Credit Suisse; CCMR; FSF; IIB; JBA; and SIFMA.

[691] *See, e.g.,* ABA; CCMR; and SIFMA.

[692] *See, e.g.,* ABA; CCMR; Credit Suisse; Data Boiler; JBA; and SIFMA.

[693] *See* SIFMA.

have to explain its inability to report a particular quantitative measurement and to provide notice if a trading desk changes its approach to including or excluding products that are not financial instruments in its metrics. The proposed rule would have required that banking entities that do not have any information to report in a Narrative Statement to submit an electronic document stating that the firm does not have any information to report in a Narrative Statement.

Most commenters generally opposed requiring banking entities to report any new information outside the scope of the 2013 rule requirements, including the Narrative Statement.[694] While recognizing that currently banking entities voluntarily provide additional information about their metrics submissions, one commenter argued that requiring the Narrative Statement would impose undue costs on banking entities, as the agencies can already obtain this information through the normal supervisory process.[695]

After considering all comments received, the agencies are not adopting the narrative statement requirement in the final rule. Rather, the final rule retains the provision from the 2013 rule's reporting instructions that permits, but does not require, firms to provide a narrative statement describing any additional information they believe would be helpful to the agencies in identifying material events or changes. Narrative statements may permit the agencies to understand aspects of the metrics without going back to the banking entities to ask questions. While the agencies anticipate that many banking entities will continue to voluntarily provide clarifying information, the agencies agree that the compliance costs associated with requiring a separate document are not commensurate with the potential benefit to the agencies of receiving information in this format from banking entities that do not wish to provide it.

7. Frequency and Method of Required Calculation and Reporting

The 2013 rule established a reporting schedule in § ▮▮.20 that required banking entities with $50 billion or more in trading assets and liabilities to report the information required by Appendix A of the 2013 rule within 10 days of the end of each calendar month. The proposed rule would have extended this reporting schedule for firms with significant trading activities, as defined in the final rule, to be within 20 days of the end of each calendar month.[696]

In general, commenters supported extending the reporting schedule to be within 20 days of the end of each calendar month.[697] Two commenters suggested further extending this to 30 days.[698] Of these, one commenter recommended reducing the frequency from monthly to quarterly in order to better align the metrics reporting with other regulatory reporting regimes.[699]

Under the final rule, metrics filers must submit metrics on a quarterly basis. In addition, the final rule retains the reporting schedule of 30 days after the end of each quarter, consistent with the reporting schedule for quarterly filers under the 2013 rule. Supervisory experience has indicated that this will reduce the incidence of errors and improve the quality of the data in the metrics submissions.

Appendix A of the 2013 rule did not specify a format in which metrics should be reported. To clarify the formatting requirements for the data submissions and to help ensure the quality and consistency of data submissions across banking entities, the proposed rule would have required banking entities to report all the information contained within the proposed appendix in accordance with an XML Schema to be specified and published on the relevant agency's website.[700]

Two commenters opposed transitioning to XML format for reporting due to the costs of changing reporting software to switch formats.[701] One commenter fully supported the use of XML as a standardized format.[702] Another commenter supported XML and estimated the cost of switching formats to be low compared to other costs involved in reporting.[703] Finally, one commenter asserted that reporting in XML could be useful in certain cases but that it was not clear that requiring metrics reporting in XML would be useful. The commenter recommended deferring the decision to adopt the XML until after a final rule is adopted. The commenter stated that the decision of whether to adopt the XML Schema requirement should be subject to separate notice and comment.[704]

The final rule adopts the use of XML for reporting metrics, following the format specified in XML Schema to be posted on the relevant agency's website. The agencies acknowledge that any changes to the metrics will impose some switching costs on banking entities. As a very common standard for data transmission, XML is expected to be a less costly format to employ than a bespoke format. Moreover, the XML Schema allows for clearer specification, which should reduce miscommunication, errors, inconsistencies, and the need for data resubmissions. The agencies believe the benefits of standardization outweigh the one-time switching costs.

8. Recordkeeping

Under paragraph III.c. of Appendix A of the 2013 rule, a banking entity's reported quantitative measurements are subject to the record retention requirements provided in Appendix A. Under the proposed rule, this provision would have been moved to paragraph III.f. and expanded to include the new qualitative information requirements added to the appendix (*i.e.,* Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement requirements). The agencies received no comments on these proposed changes. The final rule's recordkeeping requirement is being adopted largely as proposed.[705]

9. Quantitative Measurements

Section IV of Appendix A of the 2013 rule sets forth the individual quantitative measurements required by the appendix. The proposed rule would have added an "Applicability" paragraph to each quantitative measurement to identify the trading desks for which a banking entity would be required to calculate and report a particular metric based on the type of covered trading activity conducted by the desk. The proposed rule also would have removed the "General Calculation Guidance" paragraphs in section IV of Appendix A of the 2013 rule for each quantitative measurement, and provided such guidance in the Instructions.

As noted above, commenters generally supported the proposal to define "applicability" in order to clarify that certain metrics are only applicable

[694] *See, e.g.,* ABA; CCMR; Credit Suisse; Data Boiler; JBA; and SIFMA.

[695] *See* SIFMA.

[696] *See* § ▮▮.20(d) of the proposal.

[697] *See, e.g.,* FSF and Goldman Sachs.

[698] *See, e.g.,* Credit Suisse and SIFMA.

[699] *See* SIFMA.

[700] To the extent the XML Schema is updated, the version of the XML Schema that must be used by banking entities would be specified on the relevant agency's website. A banking entity must not use an outdated version of the XML Schema to report the Trading Desk Information, Quantitative Measurements Identifying Information, and applicable quantitative measurements to the relevant agency.

[701] *See, e.g.,* Credit Suisse and JBA.

[702] *See* Goldman Sachs.

[703] *See* Data Boiler.

[704] *See* SIFMA.

[705] The recordkeeping requirement in the final rule does not require that banking entities retain a copy of the Narrative Statement.

to desks engaged in market making or underwriting.[706] The agencies' received no comments on providing the metrics calculation guidance in an Instructions document and removing this guidance from the appendix. The metrics are not intended to serve as a dispositive tool for identifying permissible or impermissible activities. Thus, the agencies believe that providing the metrics calculation guidance in the Instructions and not within the regulation is more appropriate.[707] Therefore, the agencies are adopting these changes as proposed.

a. Risk-Management Measurements

i. Internal Limits and Usage

Like the 2013 rule, the proposed rule would have applied the Risk and Position Limits and Usage metric to all trading desks engaged in covered trading activities. Additionally, the proposed rule would have removed references to Stressed Value-at-Risk (Stressed VaR) in the Risk and Position Limits and Usage metric and required banking entities to report the unique identification label for each limit as listed in the Risk and Position Limits Information Schedule, the limit size (distinguishing between the upper bound and lower bound of the limit, where applicable), and the value of usage of the limit.[708]

In general, most commenters supported eliminating requirements to establish limits on Stressed VaR.[709] One commenter did not support this change, as any revisions would necessitate changes to firms' current systems and thus impose considerable operational burdens and costs.[710] Another commenter supported further requiring full reporting of upper and lower bounds of risk and position limits usage.[711]

The final rule largely adopts these changes as proposed. As noted above, the agencies believe requiring firms to submit one consolidated Internal Limits Information Schedule for the entire banking entity's covered trading activity, rather than multiple times in the Risk and Position Limits and Usage metric for different trading desks, will alleviate inefficiencies associated with reporting redundant information and reduce electronic file submission sizes. The unique identification label should allow the agencies to efficiently obtain the descriptive information regarding the limit that is separately reported in the Internal Limits Information Schedule.[712] Recognizing that firms may establish internal limits other than risk and position limits (*e.g.,* inventory aging limits), the final rule adopts an Internal Limits Information Schedule and daily Internal Limits and Usage quantitative metric.

As discussed in more detail below, the final rule removes the metrics for Risk Factor Sensitivities. Accordingly, the final rule also removes the cross reference between Risk and Position Limits and Risk Factor Sensitivities, and the cross-reference between Risk Factor Sensitivities and Profit and Loss Risk Factor Attributions. These cross-references would have provided an essential link between the limits on exposures to risk factors and the factors that are demonstrably important sources of revenue. In place of these two cross-references, the final rule adopts an identifier within the Internal Limits Information Schedule indicating the corresponding Risk Factor Attribution when a desk measures and imposes a limit on exposure to that risk factor. This identifier facilitates the agencies' review of the Internal Limits metric and its relation to gains and losses on the positions measured by that metric.

ii. Risk Factor Sensitivities

Like the 2013 rule, the proposed rule would have applied the Risk Factor Sensitivities metric to all trading desks engaged in covered trading activities. Under the proposal, a banking entity would have to report for each trading desk the unique identification label associated with each risk factor sensitivity of the desk, the magnitude of the change in the risk factor, and the aggregate change in value across all positions of the desk given the change in risk factor.

As discussed above in Quantitative Measurements Identifying Information, to reduce firms' reporting burden the final rule eliminates the Risk Factor Sensitivities quantitative measurement.

iii. Value-at-Risk and Stressed Value-at-Risk

The 2013 rule applies the Value-at-Risk and Stressed Value-at-Risk metric to all trading desks engaged in covered trading activities. The proposed rule would have modified the description of Stressed VaR to align its calculation with that of Value-at-Risk and clarified that Stressed VaR is not required to be reported for trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of financial instrument in § __.3(d)(2) of the proposal. The proposal would have also revised the definition of Value-at-Risk to provide that Value-at-Risk is the measurement of the risk of future financial loss in the value of a trading desk's aggregated positions at the ninety-nine percent confidence level over a one-day period, based on current market conditions.[713]

In general, a few commenters supported eliminating Stressed VaR, including for non-financial instrument hedging.[714] One commenter did not support this change, as any revisions would necessitate changes to firms' current systems and thus impose considerable operational burdens and costs.[715] One commenter stated that Stressed VaR was not a helpful metric because it bears an attenuated relationship to proprietary trading.[716]

After considering the comments received, the agencies believe that eliminating the Stressed VaR metric altogether will reduce burden without affecting the ability of the agencies to monitor for prohibited proprietary trading. The agencies believe that the other metrics retained or adopted in the final rule provide appropriate data to monitor for prohibited proprietary trading. To avoid duplicative or unnecessary metrics, the final rule eliminates the Stressed VaR metric.

b. Source-of-Revenue Measurements

i. Comprehensive Profit and Loss Attribution

The 2013 rule requires banking entities to calculate and report volatility of comprehensive profit and loss. The proposed rule would have eliminated this requirement as the measurement can be calculated from the profit and loss amounts reported under the Comprehensive Profit and Loss Attribution metric. Additionally, the proposed rule would have required banking entities to provide, for one or more factors that explain the

[706] *See, e.g.,* Credit Suisse; FSF; and JBA.

[707] *See supra* note 662.

[708] If a limit is introduced or discontinued during a calendar month, the banking entity must report this information for each trading day that the trading desk used the limit during the calendar month.

[709] *See, e.g.,* FSF and Data Boiler.

[710] *See* JBA.

[711] *See* Data Boiler.

[712] Such information includes the name of the limit, a description of the limit, the unit of measurement for the limit, the type of limit, and identification of the corresponding risk factor attribution in the particular case that the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported.

[713] Banking entities may base their calculations of Value-at-Risk on historical observations consistent with other applicable regulatory requirements relating to the calculation of Value-at-Risk. *See, e.g.,* 12 CFR part 3 subpart F; 12 CFR part 217 subpart F; 12 CFR part 324 subpart F.

[714] *See, e.g.,* FSF and Data Boiler.

[715] *See* JBA.

[716] *See* Goldman Sachs.

preponderance of the profit or loss changes due to risk factor changes, a unique identification label for the factor and the profit or loss due to the factor change. The proposed rule also would have required banking entities to report a unique identification label for the factor so the agencies can efficiently obtain the descriptive information regarding the factor that is separately reported in the Risk Factor Attribution Information Schedule.[717]

In general, commenters did not support requiring firms to attribute profit and loss to specific risk factors.[718] One commenter expressed concern that this could disrupt firms' current infrastructure projects to comply with the Basel Committee's revised market risk capital standards, which also require specific alignment of risk factor attribution and risk factor sensitivity hierarchies.[719] This commenter also noted the limited utility of this information for horizontal comparisons across firms as each banking organization defines these metrics at different levels of granularity. Two commenters supported eliminating the volatility calculation, as proposed.[720]

After considering these comments, the final rule adopts these changes as proposed. Under the final rule, banking entities will no longer be required to report volatility for the Comprehensive Profit and Loss metric. Banking entities will be required to provide certain information regarding the factors that explain the preponderance of the profit or loss changes due to risk factor changes when sub-attributing comprehensive profit and loss from existing positions to specific and other factors.

As in the 2013 rule and the proposal, the final rule requires trading desks to attribute profit and loss into: (i) Profit and loss attributable to a trading desk's existing positions, and (ii) profit and loss attributable to new positions. The final rule retains the category for residual profit and loss,[721] but clarifies that this is a sub-category of profit and loss attributable to existing positions.

c. Customer-Facing Activity Metrics

i. Replacement of Inventory Turnover With Positions Metric

The 2013 rule required banking entities to calculate and report inventory turnover, or the turnover of a trading desk's inventory, over a 30-day, 60-day, and 90-day reporting period. The proposed rule would have replaced the Inventory Turnover metric with the daily data underlying that metric, rather than proposing specific calculation periods. The proposal would have replaced Inventory Turnover with the daily Positions quantitative measurement. As noted in the Supplemental Information to the proposed rule, positions information that is a component of the Inventory Turnover metric would be more useful to the agencies, and is already tracked by banking entities as a component of the Inventory Turnover metric. The proposal would have limited the scope of applicability of the Positions metric to trading desks that rely on § ▮▮.4(a) or § ▮▮.4(b) to conduct underwriting activity or market making-related activity, respectively. As a result, a trading desk that did not rely on § ▮▮.4(a) or § ▮▮.4(b) would not have been subject to the proposed Positions metric.[722]

The proposal would have also required banking entities subject to the appendix to separately report the market value of all long securities positions, the market value of all short securities positions, the market value of all derivatives receivables, the market value of all derivatives payables, the notional value of all derivatives receivables, and the notional value of all derivatives payables.[723] Finally, the proposal also would have clarified that positions reported as ''derivatives'' need not be reported as ''securities,'' thereby clarifying the treatment of certain positions that may have met both definitions. This technical change would have addressed the possibility that a position could have been reported in both the ''securities'' and ''derivatives'' positions, and thus been double-counted.

A few commenters recommended that the agencies eliminate the Positions metric, but retain the inventory turnover metric.[724] These commenters expressed concern that the new ''Positions'' metric would be, in effect, a ''new'' metric that would require reporting banking entities to modify their systems to generate as a standalone metric and noted that this metric could create ''false positives'' due to daily changes in inventory that may be driven by fluctuations in the expectation of customer demand. Other commenters recommended that the agencies eliminate inventory turnover metrics reporting requirements for derivatives, including foreign exchange derivatives.[725] One commenter supported the positions metric, but recommended removing the requirement to report market values for derivative positions—as notional value measures are sufficient to assess the size of a trading desk's derivative inventory.[726]

The final rule adopts the ''Positions'' metric and eliminates the ''Inventory Turnover'' metric consistent with the proposal. The ''Positions'' metric is itself a necessary component firms already must calculate to generate the ''Inventory Turnover'' metric. Therefore, producing the ''Positions'' metric as a standalone figure would not require firms to generate additional data not produced internally today, but will result in a more effective metrics reporting framework. The agencies are aware that all changes to the metrics reporting requirements require changes to the underlying systems required to generate and report metrics to the agencies. However, the Positions metric will allow both the agencies and the firms themselves to analyze firms' trading activities over different time horizons, as appropriate; the Inventory Turnover metric, by contrast, relied on the same underlying positions data as the final rule requires to be reported, but aggregated it in a manner (with 30-day, 60-day, and 90-day rolling averages) that is more complicated than a direct reporting of positions metrics, and is less effective. The final rule differs from the proposal in that it eliminates the requirement to report the notional value of derivatives. Removing the requirement to report notional value of derivative positions will avoid potential complexity arising from using different calculation methods for determining the notional value for different types of derivatives. Additionally, as the definition of financial instrument in section ▮▮.3 lists securities, derivatives and futures as distinct types of financial instruments, the agencies are clarifying that futures positions

[717] Such information includes the name of the risk factor or other factor, a description of the risk factor or other factor, and the change unit of the risk factor or other factor.

[718] *See* SIFMA.

[719] *See* SIFMA.

[720] *See, e.g.,* Goldman Sachs and FSF.

[721] As under the 2013 rule, significant unexplained profit and loss must be escalated for further investigation and analysis under the final rule.

[722] For example, a trading desk that relies solely on § ▮▮.5 to conduct risk-mitigating hedging activity would not have been subject to the Positions metric under the proposed rule.

[723] Under the proposal, banking entities would have been required to report the effective notional value of derivatives receivables and derivatives payables for those derivatives whose stated notional amount is leveraged.

[724] *See, e.g.,* GFMA and SIFMA.

[725] *See, e.g.,* GFMA; Goldman Sachs; and State Street.

[726] *See e.g.,* Credit Suisse.

should be reported as ''derivatives,'' and are not expected to be broken out separately. The agencies are making this technical change to avoid confusion as to whether or how to classify futures for this metric.[727]

ii. Transaction Volumes and the Customer-Facing Trade Ratio

Paragraph IV.c.3. of Appendix A of the 2013 rule requires banking entities to calculate and report a Customer-Facing Trade Ratio comparing transactions involving a counterparty that is a customer of the trading desk to transactions with a counterparty that is not a customer of the desk. Appendix A of the 2013 rule requires the Customer-Facing Trade Ratio to be computed by measuring trades on both a trade count basis and value basis. In addition, Appendix A of the 2013 rule provides that the term ''customer'' for purposes of the Customer-Facing Trade Ratio is defined in the same manner as the terms ''client, customer, and counterparty'' used in § ▮▮.4(b) of the 2013 rule describing the permitted activity exemption for market making-related activities. This metric is required to be calculated on a daily basis for 30-day, 60-day, and 90-day calculation periods.

The proposed rule would have replaced the Customer-Facing Trade Ratio with a daily Transaction Volumes quantitative measurement that would allow the agencies to calculate customer-facing trade ratios over any period of time and to conduct more meaningful analysis of trading desks' customer-facing activity.[728] The proposed Transaction Volumes metric would measure the number and value [729] of all securities and derivatives transactions [730] conducted by a trading desk engaged in permitted underwriting activity or market making-related activity under the 2013 rule with four categories of counterparties: (i) Customers (excluding internal transactions); (ii) non-customers (excluding internal transactions); (iii) trading desks and other organizational units where the transaction is booked into the same banking entity; and (iv) trading desks and other organizational units where the transaction is booked into an affiliated banking entity.[731] The proposed rule would have clarified that the term ''customer'' for purposes of this metric has the same meaning as ''client, customer, and counterparty'' in § ▮▮.4(a) for underwriting desks and in § ▮▮.4(b) for market-making desks. To reduce reporting inefficiencies, the proposed rule would have only required trading desks engaged in underwriting or market making-related activity under § ▮▮.4(a) or § ▮▮.4(b) to calculate this quantitative measurement for each trading day. As with the Positions metric, the proposed rule would also have further reduced reporting volume by replacing the 30-day, 60-day, and 90-day calculation periods for each transaction with a single daily transaction value and count for each type.

The proposed rule would have required banking entities to separately report the value and number of securities and derivatives transactions conducted by a trading desk with the four categories of counterparties described above. The proposed classification of securities and derivatives described above for Positions would have also applied to Transaction Volumes.

A few commenters opposed the replacing the Customer-Facing Trade Ratio with the new Transactions Volume quantitative metric.[732] These commenters argued that the proposed changes would effectively create an entirely new metric, in particular by requiring firms to classify inter-affiliate transactions within the prescribed categories. One commenter also asserted that distinguishing trades that occur across banking entities from those within a single banking entity would not provide any informational value to the agencies in monitoring compliance with section 13 of the BHC Act.[733] One commenter supported the proposal, but also recommended excluding inter-affiliate transactions.[734]

The final rule adopts the proposed change to add a category of counterparty for desk-to-desk transactions within the same legal entity and transactions between affiliates (collectively, Internal Transactions). In order to connect the transactions metric with the other quantitate measurements, for example risk, profit and loss, and positions, it is important for transactions metrics to include all transactions conducted by the desk, including: (i) Desk-to-desk transfers within the same legal entity; (ii) transactions between affiliates; and (iii) transactions with non-affiliated external counterparties. It is also important for supervisors to be able to distinguish Internal Transactions from transactions with external non-affiliated counterparties because, based on supervisory experience under the 2013 rule, firms report these transactions inconsistently depending on a desk's purpose and business model.[735] Considering the trading activities of a desk without Internal Transactions may not give a complete picture of the desk's positions, risk exposure or trading strategies. To understand the activity of the desk the agencies need to observe its Internal Transactions.

Transactions between one trading desk and another trading desk in which the second desk books the position in the same banking entity as the first are not purchases or sales of financial instruments subject to the rule, including the prohibition on proprietary trading in § ▮▮.3. However, in practice many trading desks book positions into multiple affiliated banking entities and also engage in desk-to-desk transactions within the same legal entity. Distinguishing Internal Transactions that move positions to new legal entities from desk-to-desk transactions that occur purely within the same legal entity would require an additional layer of recordkeeping. The agencies agree that the benefit of distinguishing trades across affiliated banking entities from desk-to-desk transactions within the same legal entity does not justify the

[727] *See* final rule § ▮▮.3(c)(1) (defining ''financial instrument'' to mean (i) a security, including an option on a security; (ii) a derivative, including an option on a derivative; or (iii) a contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery).

[728] As noted in the proposal the current Customer-Facing Trade Ratio metric does not provide meaningful information when a trading desk only conducts customer-facing trading activity. The numerator of the ratio represents transactions with counterparties that are customers, while the denominator represents transactions with counterparties that are not customers. If a trading desk only trades with customers, it will not be able to calculate this ratio because the denominator will be zero.

[729] The proposal defined value to mean gross market value with respect to securities, gross notional value (*i.e.,* the current dollar market value of the quantity of the commodity underlying the derivative) for commodity derivatives, and gross notional value for all other derivatives.

[730] As noted in the Positions metric preamble, in calculating the Transactions Volume quantitative metric, futures positions should be reported as ''derivatives.''

[731] The proposal noted that in order to avoid double-counting transactions, these four categories would be exclusive of each other (*i.e.,* a transaction could only be reported in one category).

[732] *See, e.g.,* IIB and SIFMA.

[733] *See* SIFMA.

[734] *See, e.g.,* Credit Suisse.

[735] Internal Transactions are used for a number of reasons, including to transfer risk to a desk better equipped to manage the position's risk; to allow a desk with better market access or specialized market knowledge to facilitate another desk better equipped to face customers; or to allocate funding costs via transfer pricing, in which case one desk treats other internal desks or affiliate desks in much the same way as external clients. Supervisory experience has shown that, depending on the purpose of the internal transaction, banking entities sometimes report these internal transactions as transactions with customers, sometimes as transactions with non-customers, and sometimes do not report them at all.

extra record-keeping costs. The final rule consolidates these two proposed categories into one category, transactions with trading desks and other organizational units where the transaction is booked into either the same banking entity or an affiliated banking entity.

d. Securities Inventory Aging

The 2013 rule requires all trading desks engaged in covered trading activities to report Inventory Aging metrics for their securities and derivative positions. The proposed rule would have only required trading desks that relied on § __.4(a) or § __.4(b) to conduct underwriting or market making-related activity to report Inventory Aging and limited the scope of this metric to only securities positions.[736] To reflect the revised scope, the proposed rule would have revised the name of this metric to be Securities Inventory Aging. Finally, the proposal would have required a banking entity to calculate and report the Securities Inventory Aging metric according to a specific set of age ranges. Specifically, banking entities would have to calculate and report the market value of security assets and security liabilities over the following holding periods: 0–30 calendar days; 31–60 calendar days; 61–90 calendar days; 91–180 calendar days; 181–360 calendar days; and greater than 360 calendar days.

In general, commenters supported reducing the Inventory Aging metric, as inventory aging data is not readily available or particularly useful for derivative positions.[737] After consideration of comments and in light of the general desire to reduce reporting burden, the agencies believe that the Inventory Aging metric may be overly prescriptive as an indicator of compliance with the rule. Therefore, the final rule no longer requires the Inventory Aging metric for all desks and position types. For those desks where banking entities identify inventory aging as a meaningful control, the entities should report their internal limits on inventory aging under the Internal Limits and Usage metric and consequently ''Inventory Aging'' has been added as a potential type of limit under the Internal Limits Information Schedule.

V. Administrative Law Matters

A. Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act [738] requires the OCC, Board, and FDIC (Federal banking agencies) to use plain language in all proposed and final rules published after January 1, 2000. The Federal banking agencies have sought to present the proposed rule in a simple and straightforward manner and did not receive any comments on plain language.

B. Paperwork Reduction Act

Certain provisions of the final rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the agencies may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The agencies reviewed the final rule and determined that the final rule revises certain reporting and recordkeeping requirements that have been previously cleared under various OMB control numbers. The agencies did not receive any specific comments on the PRA. The agencies are extending for three years, with revision, these information collections. The information collection requirements contained in this final rule have been submitted by the OCC and FDIC to OMB for review and approval under section 3507(d) of the PRA (44 U.S.C. 3507(d)) and section 1320.11 of the OMB's implementing regulations (5 CFR 1320). The Board reviewed the final rule under the authority delegated to the Board by OMB. The Board will submit information collection burden estimates to OMB and the submission will include burden for Federal Reserve-supervised institutions, as well as burden for OCC-, FDIC-, SEC-, and CFTC-supervised institutions under a holding company. The OCC and the FDIC will take burden for banking entities that are not under a holding company.

Abstract

Section 13 to the BHC Act generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions. The exemptions allow certain types of permissible trading activities such as underwriting, market making, and risk-mitigating hedging, among others. The 2013 rule implementing section 13 became effective on April 1, 2014. Section __.20(d) and Appendix A of the 2013 final rule require certain of the largest banking entities to report to the appropriate agency certain quantitative measurements.

Current Actions

This final rule contains requirements subject to the PRA and the changes relative to the 2013 rule are discussed herein. The new and modified reporting requirements are found in sections __.4(c)(3)(i), __.20(d), __.20(i), and the Appendix. The new and modified recordkeeping requirements are found in sections, __.3(d)(3), __.4(c)(3)(i), __.5(c), __.20(b), __.20(c), __.20(d), __.20(e), __.20(f), and the Appendix. The modified information collection requirements [739] would implement section 13 of the BHC Act. The respondents are for-profit financial institutions, including small businesses. A covered entity must retain these records for a period that is no less than 5 years in a form that allows it to promptly produce such records to the relevant agency on request.

Reporting Requirements

Section __.4(c)(3)(i) requires a banking entity to make available to the agency upon request records regarding (1) any limit that is exceeded and (2) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the primary financial regulatory agency. The agencies estimate that the average time per response would be 15 minutes.

Section __.20(d) is modified by extending the reporting period for certain banking entities from within 10 days of the end of each calendar month to 30 days of the end of each calendar quarter. The threshold for reporting under section __.20(d) is modified from $10 billion or more in trading assets and liabilities to $20 billion or more in trading assets and liabilities. The metrics reporting changes to the Appendix would impact the reporting burden under section __.20(d). The agencies estimate that the current average hours per response will

[736] The proposed Securities Inventory Aging metric would not require banking entities to prepare an aging schedule for derivatives or include in its securities aging schedules those ''securities'' that are also ''derivatives,'' as those terms are defined under the 2013 rule. *See* 2013 rule §§ __.2(h), (y). *See also supra* Part III.E.2.i (discussing the classification of securities and derivatives for purposes of the proposed Positions quantitative measurement).

[737] *See, e.g.,* Data Boiler; Credit Suisse; FSF; Goldman Sachs, GFMA; and State Street.

[738] Public Law 106–102, section 722, 113 Stat. 1338, 1471 (1999).

[739] In an effort to provide transparency, the total cumulative burden for each agency is shown. In addition to the changes resulting from this final rule, the agencies are also applying a conforming methodology for calculating the burden estimates in order to be consistent across the agencies.

decrease by 14 hours (decrease 40 hours for initial set-up).

Sections ▮▮.3(b)(4), ▮▮.4(c)(4), ▮▮.20(g)(2), and ▮▮.20(h) would implicate the notice and response procedures pursuant to section ▮▮.20(i) that an agency would follow when rebutting a presumption or exercising a reservation of authority. The agencies estimate that the average hours per response would be 20 hours.

Recordkeeping Requirements

Section ▮▮.3(d)(3) would expand the scope of the recordkeeping to include foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), or cross-currency swap. The agencies estimate that the current average hour per response will not change.

Section ▮▮.4(c)(3)(i) requires a banking entity to maintain records regarding (1) any limit that is exceeded and (2) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the primary financial regulatory agency. The agencies estimate that the average time per response would be 15 minutes.

Section ▮▮.5(c) is modified by reducing the requirements for banking entities that do not have significant trading assets and liabilities and eliminating documentation requirements for certain hedging activities. The agencies estimate that the current average hours per response will decrease by 20 hours (decrease 10 hours for initial set-up).

Section ▮▮.20(b) is modified by limiting the requirement only to banking entities with significant trading assets and liabilities. The agencies estimate that the current average hour per response will not change.

Section ▮▮.20(c) is modified by limiting the CEO attestation requirement to a banking entity that has significant trading assets and liabilities. The agencies estimate that the current average hours per response will decrease by 1,100 hours (decrease 3,300 hours for initial set-up).

Section ▮▮.20(d) is modified by extending the time period for reporting for certain banking entities from within 10 days of the end of each calendar month to 30 days of the end of each calendar quarter. The agencies estimate that the current average hours per response will decrease by 3 hours.

Section ▮▮.20(e) is modified by limiting the requirement to banking entities with significant trading assets and liabilities. The agencies estimate that the current average hours per response will not change.

Section ▮▮.20(f)(2) is modified by limiting the requirement to banking entities with moderate trading assets and liabilities. The agencies estimate that the current average hours per response will not change.

The Instructions for Preparing and Submitting Quantitative Measurement Information, Technical Specifications Guidance, and XML Schema will be available on each agency's public website:

• *OCC: http://www.occ.treas.gov/topics/capital-markets/financial-markets/trading/volcker-rule-implementation/index-volcker-rule-implementation.html;*

• *Board: https://www.federalreserve.gov/apps/reportforms/review.aspx;*

• *FDIC: https://www.fdic.gov/regulations/reform/volcker/index.html;*

• *CFTC: https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_28_VolckerRule/index.htm;* and

• *SEC: https://www.sec.gov/structureddata/dera_taxonomies.*

Proposed Revision, With Extension, of the Following Information Collections

Estimated average hours per response:

Reporting

Section ▮▮.4(c)(3)(i)—0.25 hours for an average of 20 times per year.

Section ▮▮.12(e)—20 hours (Initial set-up 50 hours) for an average of 10 times per year.

Section ▮▮.20(d)—41 hours (Initial set-up 125 hours) quarterly.

Section ▮▮.20(i)—20 hours.

Recordkeeping

Section ▮▮.3(d)(3)—1 hour (Initial set-up 3 hours).

Section ▮▮.4(b)(3)(i)(A)—2 hours quarterly.

Section ▮▮.4(c)(3)(i)—0.25 hours for an average of 40 times per year.

Section ▮▮.5(c)—80 hours (Initial setup 40 hours).

Section ▮▮.11(a)(2)—10 hours.

Section ▮▮.20(b)—265 hours (Initial set-up 795 hours).

Section ▮▮.20(c)—100 hours (Initial set-up 300 hours).

Section ▮▮.20(d)– 10 hours.

Section ▮▮.20(e)—200 hours.

Section ▮▮.20(f)(1)—8 hours.

Section ▮▮.20(f)(2)—40 hours (Initial set-up 100 hours).

Disclosure

Section ▮▮.11(a)(8)(i)—0.1 hours for an average of 26 times per year.

OCC

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements Associated with Restrictions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds.

Frequency: Annual, quarterly, and event driven.

Affected Public: Businesses or other for-profit.

Respondents: National banks, state member banks, state nonmember banks, and state and federal savings associations.

OMB control number: 1557–0309.

Estimated number of respondents: 39.

Proposed revisions estimated annual burden: ¥3,503 hours.

Estimated annual burden hours: 19,823 hours (3,482 hours for initial set-up and 16,341 hours for ongoing).

Board

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements Associated with Regulation VV.

Frequency: Annual, quarterly, and event driven.

Affected Public: Businesses or other for-profit.

Respondents: State member banks, bank holding companies, savings and loan holding companies, foreign banking organizations, U.S. State branches or agencies of foreign banks, and other holding companies that control an insured depository institution and any subsidiary of the foregoing other than a subsidiary for which the OCC, FDIC, CFTC, or SEC is the primary financial regulatory agency. The Board will take burden for all institutions under a holding company including:

• OCC-supervised institutions,

• FDIC-supervised institutions,

• Banking entities for which the CFTC is the primary financial regulatory agency, as defined in section 2(12)(C) of the Dodd-Frank Act, and

• Banking entities for which the SEC is the primary financial regulatory agency, as defined in section 2(12)(B) of the Dodd-Frank Act.

Legal authorization and confidentiality: This information collection is authorized by section 13 of the BHC Act (12 U.S.C. 1851(b)(2) and 12 U.S.C. 1851(e)(1)). The information collection is required in order for covered entities to obtain the benefit of engaging in certain types of proprietary trading or investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund, under the restrictions set forth in section 13 and the final rule. If a respondent considers the information to be trade secrets and/or privileged such information could be withheld from the public under the authority of the Freedom of Information Act (5 U.S.C. 552(b)(4)). Additionally, to the extent that such information may be contained in an examination report such information could also be withheld from the public (5 U.S.C. 552 (b)(8)).

Agency form number: FR VV.

OMB control number: 7100–0360.

Estimated number of respondents: 255.

Proposed revisions estimated annual burden: ¥169,466 hours.

Estimated annual burden hours: 31,044 hours (4,035 hours for initial set-up and 27,009 hours for ongoing).

FDIC

Title of Information Collection: Volcker Rule Restrictions on Proprietary Trading and Relationships with Hedge Funds and Private Equity Funds.

Frequency: Annual, quarterly, and event driven.

Affected Public: Businesses or other for-profit.

Respondents: State nonmember banks, state savings associations, and certain subsidiaries of those entities.

OMB control number: 3064–0184.

Estimated number of respondents: 13.

Proposed revisions estimated annual burden: ¥15,172 hours.

Estimated annual burden hours: 3,115 hours (1,656 hours for initial set-up and 1,459 hours for ongoing).

C. Regulatory Flexibility Act Analysis

OCC: The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.,* (RFA), requires an agency, in connection with a final rule, to prepare a Final Regulatory Flexibility Analysis describing the impact of the rule on small entities (defined by the SBA for purposes of the RFA to include commercial banks and savings institutions with total assets of $600 million or less and trust companies with total assets of $41.5 million or less) or to certify that the rule will not have a significant economic impact on a substantial number of small entities.

The OCC currently supervises approximately 782 small entities.[740] Under the EGRRCPA, banking entities with total consolidated assets of $10 billion or less generally are not ''banking entities'' within the scope of Section 13 of the BHCA if their trading assets and trading liabilities do not exceed 5 percent of their total consolidated assets. Thus, the final rule will not impact any OCC-supervised small entities. Therefore, the OCC certifies that the final rule will not have a significant impact on a substantial number of OCC-supervised small entities.

Board: The RFA requires an agency to either provide a regulatory flexibility analysis with a rule or certify that the rule will not have a significant economic impact on a substantial number of small entities. The U.S. Small Business Administration (SBA) establishes size standards that define which entities are small businesses for purposes of the RFA.[741] Except as otherwise specified below, the size standard to be considered a small business for banking entities subject to the proposal is $600 million or less in consolidated assets.[742]

The Board has considered the potential impact of the proposed rule on small entities in accordance with the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial of number of small entities. No comments were received related to the Board's initial RFA analysis, which was published with the proposal.

As discussed in the **SUPPLEMENTARY INFORMATION**, the agencies are revising the 2013 rule in order to provide clarity to banking entities about what activities are prohibited, reduce compliance costs, and improve the ability of the agencies to make supervisory assessments regarding compliance relative to the 2013 rule. The agencies are explicitly authorized under section 13(b)(2) of the BHC Act to adopt rules implementing section 13.[743]

The Board's rule generally applies to state-chartered banks that are members of the Federal Reserve System, bank holding companies, foreign banking organizations, and nonbank financial companies supervised by the Board (collectively, Board-regulated entities). However, EGRRCPA, which was enacted on May 24, 2018, amended section 13 of the BHC Act and modified the scope of the definition of banking entity by amending the term ''insured depository institution'' to exclude certain community banks.[744] The Board is not aware of any Board-regulated entities that meet the SBA's definition of ''small entity'' that are subject to section 13 of the BHC Act and the rule following the enactment of EGRRCPA. Furthermore, to the extent that any Board-regulated entities that meet the definition of ''small entity'' are or become subject to section 13 of the BHC Act and the rule, the Board does not expect the total number of such entities to be substantial. Accordingly, the Board's rule is not expected to have a significant economic impact on a substantial number of small entities.

The Board has not identified any federal statutes or regulations that would duplicate, overlap, or conflict with the proposed revisions, and the Board is not aware of any significant alternatives to the rule that would reduce the economic impact on Board-regulated small entities.

FDIC

(a) Regulatory Flexibility Analysis

The RFA generally requires an agency, in connection with a final rule, to prepare and make available for public comment a final regulatory flexibility analysis that describes the impact of a rule on small entities.[745] However, a regulatory flexibility analysis is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The SBA has defined ''small entities'' to include banking organizations with total assets of less than or equal to $600 million.[746]

[740] The number of small entities supervised by the OCC is determined using the SBA's size thresholds for commercial banks and savings institutions, and trust companies, which are $600 million and $41.5 million, respectively. Consistent with the General Principles of Affiliation 13 CFR 121.103(a), the OCC counts the assets of affiliated financial institutions when determining if the OCC should classify an OCC-supervised institution a small entity. The OCC used December 31, 2018, to determine size because a ''financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.'' See footnote 8 of the U.S. Small Business Administration's *Table of Size Standards.*

[741] U.S. SBA, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, available at *https://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf.*

[742] *See id.* Pursuant to SBA regulations, the asset size of a concern includes the assets of the concern whose size is at issue and all of its domestic and foreign affiliates. 13 CFR 121.103(6).

[743] 12 U.S.C. 1851(b)(2).

[744] Under EGRRCPA, a community bank and its affiliates are generally excluded from the definition of banking entity, and thus section 13 of the BHC Act, if the bank and all companies that control the bank have total consolidated assets equal to $10 billion or less and trading assets and liabilities equal to 5 percent or less of total consolidated assets.

[745] 5 U.S.C. 601 *et seq.*

[746] The SBA defines a small banking organization as having $600 million or less in assets, where an organization's ''assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year.'' See 13 CFR 121.201 (as amended by 84 FR 34261, effective August 19, 2019). In its determination, the ''SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates.'' See 13 CFR 121.103. Following these regulations, the FDIC uses

Continued

Generally, the FDIC considers a significant effect to be a quantified effect in excess of 5 percent of total annual salaries and benefits per institution, or 2.5 percent of total noninterest expenses. The FDIC believes that effects in excess of these thresholds typically represent significant effects for FDIC-supervised institutions. As discussed further below, the FDIC certifies that this final rule will not have a significant economic impact on a substantial number of FDIC-supervised small entities.

(b) Reasons for and Policy Objectives of the Final Rule

The agencies are issuing this final rule to amend the 2013 rule in order to provide banking entities with additional clarity and certainty about what activities are prohibited and seek to improve the efficacy of the regulations where possible. The agencies acknowledge that many banking entities have found certain aspects of the 2013 rule to be complex or difficult to apply in practice. This final rule amends the 2013 rule to make its requirements more efficient.

(c) Description of the Rule

First, the FDIC is amending its regulations to tailor the application of the final rule based on the size and scope of a banking entity's trading activities. In particular, the FDIC aims to further reduce compliance obligations for firms that do not have large trading operations and therefore reduce costs and uncertainty faced by firms in complying with the final rule, relative to their amount of trading activity. In addition to tailoring the application of the final rule, the FDIC is also streamlining and clarifying for all banking entities certain definitions and requirements related to the proprietary trading prohibition and limitations on covered fund activities and investments. Finally, the FDIC is reducing reporting, recordkeeping, and compliance program requirements for all banking entities and expanding tailoring to make the scale of compliance activity required by the rule commensurate with a banking entity's size and level of trading activity.

(d) Other Statutes and Federal Rules

On May 24, 2018, EGRRCPA was enacted, which, among other things, amends section 13 of the BHC Act. As a result, section 13 excludes from the definition of ''banking entity'' any institution that, together with their affiliates and subsidiaries, has: (1) Total assets of $10 billion or less, and (2) trading assets and liabilities that comprise 5 percent or less of total assets.

The FDIC has not otherwise identified any likely duplication, overlap, and/or potential conflict between this final rule and any other federal rule.

(e) Small Entities Affected

The FDIC supervises 3,465 depository institutions,[747] of which, 2,705 are defined as small banking organizations according to the RFA.[748] Almost all FDIC-supervised small banking entities are exempt from the requirements of section 13 of the BHC Act, pursuant to EGRRCPA, and hence the final rule does not affect them.

Only one FDIC-supervised small banking entity is not exempt from the requirements of section 13 of the BHC Act under EGRRCPA because it has trading assets and liabilities greater than five percent of total consolidated assets. This bank has trading activity at levels that would place it in the final rule's limited trading assets and liabilities compliance category, and it thus could benefit from the final rule which contains a rebuttable presumption of compliance for such banking entities. The FDIC estimates that banks with limited trading will save, on average, $115,233 from the reduced burden of this rule. This amount is far less than 5 percent of total salaries and 2.5 percent of total non-interest expenses for this one institution.

Consequently, the FDIC does not believe that this rule will have a significant economic impact on a substantial number of small entities.

(f) Certification Statement

Section 13 of the BHC Act, as amended by EGRRCPA, exempts all but one of the 2,705 FDIC-supervised small banking entities from compliance with section 13 of the BHC Act. Therefore, the FDIC certifies that this final rule will not have a significant economic impact on a substantial number of FDIC-supervised small banking entities.

CFTC: Pursuant to 5 U.S.C. 605(b), the CFTC hereby certifies that the amendments to the 2013 final rule will not have a significant economic impact on a substantial number of small entities for which the CFTC is the primary financial regulatory agency.

As discussed in this **SUPPLEMENTARY INFORMATION**, the Agencies are revising the 2013 final rule in order to provide clarity to banking entities about what activities are prohibited, reduce compliance costs, and improve the ability of the Agencies to make assessments regarding compliance relative to the 2013 final rule. To minimize the costs associated with the 2013 final rule, the Agencies are simplifying and tailoring the rule to allow banking entities to more efficiently provide financial services in a manner that is consistent with the requirements of section 13 of the BHC Act.

The revisions will generally apply to banking entities, including certain CFTC-registered entities. These entities include bank-affiliated CFTC-registered swap dealers, futures commission merchants, commodity trading advisors and commodity pool operators.[749] The CFTC has previously determined that swap dealers, futures commission merchants and commodity pool operators are not small entities for purposes of the RFA and, therefore, the requirements of the RFA do not apply to those entities.[750] As for commodity trading advisors, the CFTC has found it appropriate to consider whether such registrants should be deemed small entities for purposes of the RFA on a case-by-case basis, in the context of the particular regulation at issue.[751]

In the context of the revisions to the 2013 final rule, the CFTC believes it is unlikely that a substantial number of the commodity trading advisors that are potentially affected are small entities for purposes of the RFA. In this regard, the CFTC notes that only commodity trading advisors that are registered with the CFTC are covered by the 2013 final rule, and generally those that are registered have larger businesses. Similarly, the 2013 final rule applies to only those commodity trading advisors that are affiliated with banks that are within the scope of the Volcker Rule, which the CFTC expects are larger businesses.[752]

a covered entity's affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the covered entity is ''small'' for the purposes of RFA.

[747] Categories of FDIC-supervised depository institutions are set forth in 12 U.S.C. 1813(q)(2).

[748] FDIC Call Report, March 31, 2019.

[749] The revisions may also apply to other types of CFTC registrants that are banking entities, such as introducing brokers, but the CFTC believes it is unlikely that such other registrants will have significant activities that would implicate the revisions. *See* 2013 final rule (CFTC), 79 FR 5808 at 5813 (Jan. 31, 2014).

[750] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982) (futures commission merchants and commodity pool operators); and Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620 (Jan. 19, 2012) (swap dealers and major swap participants).

[751] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18620 (Apr. 30, 1982).

[752] In this regard, the CFTC notes that the agencies recently revised the 2013 final rule in

The CFTC requested that commenters address whether any CFTC registrants covered by the proposed revisions to the 2013 final rule are small entities for purposes of the RFA. The CFTC did not receive any public comments on this or any other aspect of the RFA as it relates to the rule.

Because the CFTC believes there are not a substantial number of commodity trading advisors within the scope of the Volcker Rule that are small entities for purposes of the RFA, and the other CFTC registrants that may be affected by the proposed revisions have been determined not to be small entities, the CFTC believes that the revisions to the 2013 final rule will not have a significant economic impact on a substantial number of small entities for which the CFTC is the primary financial regulatory agency.

SEC: In the proposal, the SEC certified that, pursuant to 5 U.S.C. 605(b), the proposal would not, if adopted, have a significant economic impact on a substantial number of small entities. Although the SEC solicited written comments regarding this certification, no commenters responded to this request.

As discussed in the **SUPPLEMENTARY INFORMATION**, the Agencies are adopting revisions to the 2013 rule that are intended to provide banking entities with clarity about what activities are prohibited and improve supervision and implementation of section 13 of the BHC Act.

The revisions the agencies are adopting today will generally apply to banking entities, including certain SEC-registered entities.[753] These entities include SEC-registered broker-dealers, investment advisers, security-based swap dealers, and major security-based swap participants that are affiliates or subsidiaries of an insured depository institution.[754] Based on information in filings submitted by these entities, the SEC believes that there are no banking entity registered investment advisers,[755] broker-dealers,[756] security-based swap dealers, or major security-based swap participants that are small entities for purposes of the RFA.[757] For this reason, the SEC certifies that the rule, as adopted, will not have a significant economic impact on a substantial number of small entities.

D. Riegle Community Development and Regulatory Improvement Act

Section 302(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) [758] requires that each Federal banking agency, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. The agencies have considered comment on these matters in other parts of this **SUPPLEMENTARY INFORMATION.**

In addition, under section 302(b) of the RCDRIA, new regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally must take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form.[759] Therefore, the effective date for the OCC, Board, and FDIC is January 1, 2020, the first day of the calendar quarter.[760]

E. OCC Unfunded Mandates Reform Act Determination

The OCC has analyzed the rule under the factors set forth in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the rule includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted for inflation). The cost estimate for the final rule is approximately $4.1 million in the first year. Therefore, the OCC finds that the final rule does not trigger the UMRA cost threshold. Accordingly, the OCC has not prepared the written statement described in section 202 of the UMRA.

F. SEC Economic Analysis

1. Broad Economic Considerations

a. Scope

As discussed above, section 13 of the Bank Holding Company (BHC) Act generally prohibits banking entities from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (covered funds), subject to certain exemptions. Section 13(h)(1) of the BHC Act defines the term ''banking entity'' to include (i) any insured depository institution (as defined by statute), (ii) any company that controls an insured depository institution, (iii) any company that is treated as a bank holding company for purposes of section 8 of the

order to be consistent with statutory amendments made by EGRRCPA to section 13 of the BHC Act. The general result of one of these statutory revisions was to exclude community banks and their affiliates and subsidiaries from the scope of the Volcker Rule. *See* 84 FR 35008. The CFTC believes this exclusion lessens the likelihood that any commodity trading advisors that remain within the scope of the Volcker Rule are small entities.

[753] The SEC's Economic Analysis, below, discusses the economic effects of the final amendments. *See* SEC Economic Analysis, *supra* Part V.F.

[754] *See* 2013 rule § _.2(c) (definition of banking entity); 2013 rule § _.2(r) as amended (definition of insured depository institution).

[755] For the purposes of an SEC rulemaking in connection with the RFA, an investment adviser generally is a small entity if it: (1) Has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year. *See* 17 CFR 275.0–7.

[756] For the purposes of an SEC rulemaking in connection with the RFA, a broker-dealer will be deemed a small entity if it: (1) Had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a–5(d), or, if not required to file such statements, had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization. *See* 17 CFR 240.0–10(c). Under the standards adopted by the SBA, small entities also include entities engaged in financial investments and related activities with $38.5 million or less in annual receipts. *See* 13 CFR 121.201 (Subsector 523).

[757] Based on SEC analysis of Form ADV data, the SEC believes that there are not a substantial number of registered investment advisers affected by the proposal that qualify as small entities under RFA. Based on SEC analysis of broker-dealer FOCUS filings and NIC relationship data, the SEC believes that there are no SEC-registered broker-dealers affected by the proposal that qualify as small entities under RFA. With respect to security-based swap dealers and major security-based swap participants, based on feedback from market participants and information about the security-based swap markets, the Commission believes that the types of entities that would engage in more than a *de minimis* amount of dealing activity involving security-based swaps—which generally would be large financial institutions—would not be ''small entities'' for purposes of the RFA. *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 81 FR 53546, 53553 (Aug. 12, 2016).

[758] 12 U.S.C. 4802(a).

[759] 12 U.S.C. 4802(b).

[760] Additionally, the Administrative Procedure Act generally requires that the effective date of a rule be no less than 30 days after publication in the **Federal Register.** 5 U.S.C. 553(d)(1). The effective date, January 1, 2020, will be more than 30 days after publication in the **Federal Register.**

International Banking Act of 1978, and (iv) any affiliate or subsidiary of such an entity.[761] In addition, as discussed above, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), enacted on May 24, 2018, amended section 13 of the BHC Act to exclude from the definition of ''insured depository institution'' any institution that does not have and is not controlled by a company that has (1) more than $10 billion in total consolidated assets; and (2) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5% of total consolidated assets.[762]

Certain SEC-regulated entities, such as broker-dealers, security-based swap dealers (SBSDs), and registered investment advisers (RIAs) affiliated with a banking entity, fall under the definition of ''banking entity'' and are subject to the prohibitions of section 13 of the BHC Act.[763] This economic analysis is limited to areas within the scope of the SEC's function as the primary securities markets regulator in the United States. In particular, the SEC's economic analysis is focused on the potential effects of the final rule on SEC registrants, in their capacity as such, the functioning and efficiency of the securities markets, investor protection, and capital formation. SEC registrants affected by the final rule include SEC-registered broker-dealers, SBSDs, and RIAs. Thus, the below analysis does not consider broker-dealers, SBSDs, and investment advisers that are not banking entities, or banking entities that are not SEC registrants, in either case for purposes of section 13 of the BHC Act, beyond the potential spillover effects on these entities and effects on efficiency, competition, investor protection, and capital formation in securities markets. Other sections of this **SUPPLEMENTARY INFORMATION** discuss the effects of the final rule on banking entities not overseen by the SEC for purposes of section 13 of the BHC Act.

In the proposal, the SEC solicited comment on all aspects of the costs and benefits associated with the proposed amendments for SEC registrants, including any spillover effects the proposed amendments may have on efficiency, competition, and capital formation in securities markets. The SEC has considered these comments, as discussed in greater detail in the sections that follow.

b. Economic Effects and Justification

As stated in the proposal, in implementing section 13 of the BHC Act, the agencies sought to increase the safety and soundness of banking entities, promote financial stability, and reduce conflicts of interest between banking entities and their customers.

In the proposal, the SEC recognized a number of effects of the 2013 rule.[764] The SEC continues to recognize that distinguishing between permissible and prohibited activities may be complex and costly for some firms,[765] which may impede the conduct of permissible activities.[766] The SEC continues to believe that the 2013 rule may have resulted in a complex and costly compliance regime that is unduly restrictive and burdensome for some banking entities, particularly smaller firms that do not qualify for the simplified compliance regime.[767] Since the 2013 rule became effective, new estimates regarding compliance burdens and new information about the various effects of the 2013 rule have become available.[768] The passage of time has also enabled an assessment of the value of individual requirements that enable SEC oversight, such as the requirement to report certain quantitative metrics, relative to reporting and other compliance burdens.[769]

As discussed below, a number of commenters have indicated that the proposed amendments would have altered the scope of permissible activities and compliance requirements of the 2013 rule in a way that significantly affects the economic costs and benefits of the 2013 rule. In addition, commenters offered a variety of views on the baseline economic effects, which include section 13 of the BHC Act, the 2013 rule, sections 203 and 204 of EGRRCPA and conforming amendments, and current practices of banking entities aimed at compliance with these regulations.[770] As part of the proposal's economic baseline, the SEC discussed the effects of the agencies' 2013 rule.[771] The economic baseline section below discusses these effects in greater detail.

The final rule includes amendments that impact the scope of permitted activities for all or a subset of banking entities (*e.g.,* trading account definition, underwriting and market making, and trading and investing activities by foreign banking entities), and amendments that simplify, tailor, or eliminate the application of certain aspects of the 2013 rule intended to reduce compliance and reporting burdens while preserving and, in some cases, enhancing the effectiveness of the 2013 rule. Many of the final amendments seek to provide greater clarity and certainty about which activities are permitted under the 2013 rule, which may increase the ability and willingness of banking entities to engage in permitted activities, and to promote the effective allocation of compliance resources.

Broadly, the SEC believes that a greater ability and willingness to engage in permitted activities would benefit the parties to those transactions and capital markets as a whole. Reduced compliance costs may translate into increased willingness of banking entities to engage in activities that facilitate risk-sharing and capital formation, such as underwriting securities and making markets. Accordingly, the rule may also benefit clients, customers, and counterparties in the form of an increased ability to transact with banking entities.

The SEC continues to recognize that some of these changes may also, in certain circumstances, increase activities involving risk exposure or increase the incidence of conflicts of interest among some market participants. The returns and risks from

[761] *See* 12 U.S.C. 1851(h)(1).

[762] These and other aspects of the regulatory baseline against which the SEC is assessing the economic effects of the final rule on SEC banking entities are discussed in the economic baseline. On July 22, 2019, the agencies adopted a final rule amending the definition of ''insured depository institution'' in a manner consistent with EGRRCPA.

[763] Throughout this economic analysis, the term ''banking entity'' generally refers only to banking entities for which the SEC is the primary financial regulatory agency unless otherwise noted. While section 13 of the BHC Act and its associated rules apply to a broader set of banking entities, this economic analysis is limited to those banking entities for which the SEC is the primary financial regulatory agency as defined in Section 2(12)(B) of the Dodd-Frank Act. *See* 12 U.S.C. 1851(b)(2); 12 U.S.C. 5301(12)(B).

Compliance with SBSD registration requirements is not yet required and there are currently no registered SBSDs. However, the SEC has previously estimated that as many as 50 entities may potentially register as SBSDs and that as many as 16 of these entities may already be SEC-registered broker-dealers. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, Exchange Act Release No. 86175 (June 21, 2019), 84 FR at 43872 (Aug. 22, 2019), (henceforth ''Capital, Margin, and Segregation Adopting Release'').

For the purposes of this economic analysis, the term ''dealer'' generally refers to SEC-registered broker-dealers and SBSDs.

[764] *See* 83 FR at 33520–33552.

[765] *See, e.g.,* 83 FR at 33521.

[766] *See, e.g.,* 83 FR at 33532.

[767] *Id.*

[768] *See, e.g.,* 83 FR at 33522.

[769] *Id.*

[770] *See, e.g.,* Occupy the SEC; Better Markets; SIFMA and Center for American Entrepreneurship.

[771] *See* 83 FR at 33520–33521.

the activities of banking entities may flow through to their investors. In general, to the extent that the final rule increases or decreases the scope of permissible activities, the final rule may dampen or magnify some of the economic tensions inherent in this rulemaking. As discussed above, various aspects of the final rule are designed to ensure that the prudential objectives of the rule are not diminished. Moreover, amendments adopted as part of the final rule that redefine the scope of entities subject to certain provisions of the 2013 rule may have an effect on competition, allocative efficiency, and capital formation. Where the final rule reduces burdens on some groups of market participants (*e.g.,* on banking entities without significant trading assets and liabilities and certain foreign banking entities), the final rule is expected to increase competition and trading activity in related market segments.

Other amendments to the 2013 rule reduce compliance program, reporting, and documentation requirements for some banking entities. The SEC believes that these amendments may reduce the compliance burdens of SEC-regulated banking entities, which may enhance competition, trading activity, and capital formation. The SEC recognizes that these amendments may alter the mix of tools available for regulatory oversight and supervision. However, the SEC believes that the final rule as a whole is unlikely to reduce the efficacy of the agencies' regulatory oversight.[772] Further, under the final rule, banking entities (other than banking entities with limited trading assets and liabilities for which the presumption of compliance has not been rebutted) are still required to develop and provide for the continued administration of a compliance program that is reasonably designed to ensure and monitor compliance with the prohibitions and restrictions set forth in section 13 of the BHC Act. Finally, the final rule does not change the scope of entities subject to the statutory obligations and prohibitions of section 13 of the BHC Act.

c. Analytical Approach

The SEC's economic analysis is informed by research on the effects of section 13 of the BHC Act and the 2013 rule and on related incentives conflicts, by comments received by the agencies from a variety of interested parties, and by the agencies' experience administering the 2013 rule since its adoption. Throughout this economic analysis, the SEC discusses how different market participants may respond to various aspects of the final rule and considers the potential effects of the final rule on activities by banking entities that involve risk, on their willingness and ability to engage in client-facilitation activities, and on competition, market quality, and capital formation, as informed, among other things, by research and comment letters. The SEC's analysis also recognizes that the overall risk exposure of banking entities may arise out of a combination of activities, including proprietary trading, market making, and traditional banking, as well as the volume and structure of hedging and other risk-mitigating activities. As discussed further below, the SEC recognizes the complex baseline effects of section 13 of the BHC Act, as amended by sections 203 and 204 of EGRRCPA, and implementing rules, on overall levels and structure of banking entity risk exposures.

The SEC also considered the investor protection implications of the final rule. Broadly, the SEC notes that market liquidity can be important to investors as it may enable investors to exit (in a timely manner and at an acceptable price) from their positions in instruments, products, and portfolios. At the same time, excessive risk exposures of banking entities can adversely affect markets and, therefore, investors.

The final rule tailors, removes, or alters the scope of various requirements in the 2013 rule and adds certain new requirements. Since section 13 of the BHC Act and the 2013 rule combined a number of different requirements, and, as discussed above, the type and level of risk exposure of a banking entity is the result of a combination of activities,[773] it is difficult to attribute the observed effects to a specific provision or set of requirements. In addition, analysis of the effects of the implementation of the 2013 rule is confounded by macroeconomic factors, other policy interventions, and post-crisis changes to market participants' risk aversion and return expectations. Because of the extended timeline of implementation of section 13 of the BHC Act and the overlap of the 2013 rule period with other post-crisis changes affecting the same group or certain sub-groups of SEC registrants, the SEC cannot rely on typical quantitative methods that might otherwise enable causal attribution and quantification of the effects of section 13 of the BHC Act and the 2013 rule on measures of capital formation, liquidity, competition, and informational or allocative efficiency. Moreover, empirical measures of capital formation or liquidity do not reflect issuance and transaction activity that does not occur as a result of the 2013 rule. Accordingly, it is difficult to quantify the primary issuance and secondary market liquidity that would have been observed following the financial crisis absent various provisions of Section 13 of the BHC Act and the 2013 final rule.

Importantly, the existing securities markets—including market participants, their business models, market structure, etc.—differ in significant ways from the securities markets that existed prior to enactment of Section 13 of the BHC Act and the implementation of the 2013 rule. For example, the role of dealers in intermediating trading activity has changed in important ways, including the following: In recent years, on both an absolute and relative basis bank-dealers generally committed less capital to intermediation activities while nonbanking dealers generally committed more; the volume and profitability of certain trading activities after the financial crisis may have decreased for bank-dealers while it may have increased for other intermediaries, including nonbanking entities that provide intraday liquidity using sophisticated electronic trading algorithms and high speed access to data and trading venues; and the introduction of alternative credit markets may have contributed to liquidity fragmentation across markets while potentially increasing access to capital.[774]

Where possible, this analysis attempts to quantify the costs and benefits expected to result from the final rule. In many cases, however, the SEC is unable to quantify these potential economic effects. Some of the primary economic effects, such as the effect on incentives that may give rise to conflicts of interest in various regulated entities and the efficacy of regulatory oversight under various compliance regimes, are inherently difficult to quantify. Moreover, some of the benefits of the 2013 rule's prohibitions that are being amended here, such as potential benefits for resilience during a crisis, are less readily observable under strong economic conditions and cannot be isolated from the effects of other post-crisis regulatory efforts intended to enhance resilience. Lastly, because of overlapping implementation periods of various post-crisis regulations affecting

[772] *See, e.g.,* sections IV.B.2 and IV.D.1.

[773] *See, e.g.,* 79 FR 5541.

[774] *See* Sec. & Exch. Comm'n, Access To Capital And Market Liquidity, (2017) [hereinafter SEC Report 2017].

the same group or certain sub-groups of SEC registrants, the long implementation timeline of the 2013 rule, and the fact that many market participants changed their behavior in anticipation of future changes in regulation, it is difficult to quantify the net economic effects of individual amendments to the 2013 rule adopted here.

In some instances, the SEC lacks the information or data necessary to provide reasonable estimates for the economic effects of the final rule. For example, the SEC lacks information and data, and commenters have not provided such information or data, to allow a quantification of (1) the volume of trading activity that does not occur because of uncertainty about how to demonstrate that underwriting or market making activities satisfy the reasonably expected near-term demand (RENTD) requirement; (2) the extent to which internal limits may capture expected customer demand; (3) how accurately correlation analysis reflects underlying exposures of banking entities with, and without, significant trading assets and liabilities in normal times and in times of market stress; (4) the feasibility and costs of reorganization that may enable some U.S. banking entities to become foreign banking entities for the purposes of relying on the foreign trading exemption; and (5) the extent of the overall risk reduction (if any) caused by the 2013 rule. Where the SEC cannot quantify the relevant economic effects, the SEC discusses them in qualitative terms.

2. Baseline

The baseline against which the SEC is assessing the economic effects of the final rule includes the legal and regulatory framework as it exists at the time of this release and current practices aimed at compliance with these regulations.

a. Regulation

The regulatory baseline includes section 13 of the BHC Act, as amended by EGRRCPA, and the 2013 rule, as amended by the agencies' amendments conforming to EGRRCPA. Further, the baseline accounts for the fact that since the adoption of the 2013 rule, the staffs of the agencies have provided FAQ responses to questions about the 2013 rule.[775] In addition, the federal banking agencies released a 2019 policy statement with respect to foreign excluded funds.[776]

The subsections below discuss in greater detail the legal and regulatory baseline applicable to entities that are registered with the SEC and that the SEC oversees for purposes of section 13 of the BHC Act. In particular, the SEC discusses the exemptions for permissible underwriting and market making-related activities, risk-mitigating hedging, and foreign trading; requirements and exemptions related to covered funds; compliance and metrics reporting requirements; and sections of EGRRCPA and conforming amendments that exempt certain banking entities from section 13 of the BHC Act and the 2013 rule.

i. The 2013 Rule

(1) Definition of the Trading Account

The scope of prohibited proprietary trading activity is determined by the definition of ''trading account'' and related exclusions.[777] As discussed in detail in section IV.B.1.a, the 2013 rule's definition of trading account includes three prongs: The short-term intent prong, the market risk capital rule prong, and the dealer prong. In addition, the 2013 rule includes a rebuttable presumption, under which a purchase (or sale) of a financial instrument is presumed to be for the trading account under the short-term intent prong if the banking entity holds the financial instrument for fewer than 60 days or substantially transfers the risk of the financial instrument within 60 days of the purchase (or sale).

The 2013 rule provides several exclusions from the definition of proprietary trading in section § ■■.3(d). In particular, under certain conditions, the 2013 rule excludes from the definition of proprietary trading any purchases or sales that arise under a repurchase or reverse repurchase agreement or under a transaction in which the banking entity lends or borrows a security temporarily, any purchase or sale of a security for the purpose of liquidity management in accordance with a documented liquidity management plan,[778] any purchase or sale by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments, any excluded clearing activities, any purchase or sale that satisfies an existing delivery obligation or an obligation in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding, any purchase or sale by a banking entity that is acting solely as agent, broker, or custodian, any purchase or sale through a deferred compensation, stock-bonus, profit-sharing, or pension plan, and any purchase or sale in the ordinary course of collecting a debt previously contracted in good faith.

In addition, section § ■■.3(e)(13) of the 2013 rule defines ''trading desk'' 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, and applies certain requirements at the ''trading desk''-level of organization.[779]

(2) Exemption for Underwriting and Market Making-Related Activity

Section 13(d)(1)(B) of the BHC Act contains an exemption from the prohibition on proprietary trading for underwriting and market making-related activities. Under the 2013 rule, all banking entities with covered activities must satisfy several requirements with respect to their underwriting activities to qualify for the exemption for underwriting activities, discussed in detail in section IV.B.2.a above.[780] In addition, under the current baseline, all banking entities with covered activities must satisfy six requirements with respect to their market making-related activities to qualify for the exemption for market making-related activities, as discussed in section IV.B.2.a.[781]

The SEC also notes that, under the baseline, an organizational unit or a trading desk of another banking entity that has consolidated trading assets and liabilities of $50 billion or more is generally not considered a client, customer, or counterparty for the purposes of the RENTD requirement.[782] Thus, such demand does not contribute to RENTD unless such demand is affected through an anonymous trading facility or unless the trading desk documents how and why the organizational unit of said large banking entity should be treated as a client,

[775] *See https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm,* originally published on June 10, 2014, and most recently updated on March 4, 2016.

[776] *See* Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 17, 2019), *available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20190717a1.pdf.* This policy statement continued the position of the Federal banking agencies that was released on July 21, 2017, and the position that the agencies expressed in the proposal. *See* 83 FR 33444.

[777] This aspect of the baseline is discussed in section V.F.3.b.

[778] This aspect of the baseline is discussed in section IV.B.1.b.i.

[779] *See* 2013 rule §§ ■■.4, ■■.5, App. A., App. B; final rule §§ ■■.4, ■■.5, App. A.

[780] *See* 2013 rule § ■■.4 (a).

[781] *See* 2013 rule § ■■.4 (b).

[782] *See* 2013 rule § ■■.4 (b)(3)(i).

customer, or counterparty. To the extent that such documentation requirements increase the cost of intermediating interdealer transactions, this requirement may affect the volume and cost of interdealer trading.

(3) Exemption for Risk-Mitigating Hedging

Under the baseline, certain risk-mitigating hedging activities may be exempt from the restriction on proprietary trading under the risk-mitigating hedging exemption. To make use of this exemption, the 2013 rule requires all banking entities to comply with a comprehensive and multi-faceted set of requirements, including (1) the establishment, implementation, and maintenance of an internal compliance program; (2) satisfaction of various criteria for hedging activities; and (3) the existence of compensation arrangements for persons performing risk-mitigating hedging activities that are designed not to reward or incentivize prohibited proprietary trading. In addition, certain activities under the exemption for risk-mitigating hedging are subject to documentation requirements.[783]

Specifically, the 2013 rule requires that a banking entity seeking to rely on the exemption for risk-mitigating hedging must establish, implement, maintain, and enforce an internal compliance program that includes reasonably designed written policies and procedures regarding the positions, techniques, and strategies that may be used for hedging, including documentation indicating what positions, contracts, or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts, or other holdings. The compliance program must also provide for internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures. In addition, the 2013 rule requires that all banking entities, as part of their compliance program, must conduct analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques, and strategies that may be used for hedging are designed to reduce or otherwise significantly mitigate and demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged.

The 2013 rule does not require a banking entity to prove correlation mathematically—rather, the nature and extent of the correlation analysis should be dependent on the facts and circumstances of the hedge and the underlying risks targeted. Moreover, if correlation cannot be demonstrated, the analysis needs to state the reason and explain how the proposed hedging position, technique, or strategy is designed to reduce or significantly mitigate risk and how that reduction or mitigation can be demonstrated without correlation.[784] In the proposal, the SEC referenced market participants' estimate that the inability to perform correlation analysis, for instance, for non-trading assets such as mortgage servicing assets, can add as much as 2% of the asset value to the cost of hedging.[785]

To qualify for the exemption for risk-mitigating hedging, the hedging activity, both at inception and at the time of any adjustment to the hedging activity, must be designed to reduce or otherwise significantly mitigate and demonstrably reduce or significantly mitigate one or more specific identifiable risks.[786] Hedging activities also must not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously. Additionally, the hedging activity must be subject to continuing review, monitoring, and management by the banking entity, including ongoing recalibration of the hedging activity to ensure that the hedging activity satisfies the requirements for the exemption and does not constitute prohibited proprietary trading.

Finally, the 2013 rule requires banking entities to document and retain information related to the purchase or sale of hedging instruments that are either (1) established by a trading desk that is different from the trading desk establishing or responsible for the risks being hedged; (2) established by the specific trading desk establishing or responsible for the risks being hedged but that are effected through means not specifically identified in the trading desk's written policies and procedures; or (3) established to hedge aggregate positions across two or more trading desks.[787] The documentation must include the specific identifiable risks being hedged, the specific risk-mitigating strategy that is being implemented, and the trading desk that is establishing and responsible for the hedge. These records must be retained for a period of not less than 5 years in a form that allows them to be promptly produced if requested.[788]

(4) Exemption for Foreign Trading

Under the 2013 rule, a foreign banking entity that has a branch, agency, or subsidiary located in the United States (and is not itself located in the United States) is subject to the proprietary trading prohibitions and related compliance requirements unless the transaction meets five criteria.[789] First, a branch, agency, or subsidiary of a foreign banking organization that is located in the United States or organized under the laws of the United States or of any state may not engage as principal in the purchase or sale of financial instruments (including any personnel that arrange, negotiate, or execute a purchase or sale). Second, the banking entity (including relevant personnel) that makes the decision to engage in the transaction must not be located in the United States or organized under the laws of the United States or of any state. Third, the transaction, including any transaction arising from risk-mitigating hedging related to the transaction, must not be accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any state. Fourth, no financing for the transaction can be provided by any branch or affiliate of a foreign banking entity that is located in the United States or organized under the laws of the United States or of any state (the financing prong). Fifth, the transaction must generally not be conducted with or through any U.S. entity (the counterparty prong), unless (1) no personnel of a U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such transaction; (2) the transaction is with an unaffiliated U.S. market intermediary acting as principal and is promptly cleared and settled through a central counterparty; or (3) the transaction is executed through an unaffiliated U.S. market intermediary acting as agent, conducted anonymously through an

[783] *See* 2013 rule § ■■.5.

[784] *See* 79 FR 5631.

[785] *See* 83 FR at 33534 citing to note 18 regarding Notice Seeking Public Input on the Volcker Rule (August 2017), *available at https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf.* Corresponding comment letters are available at *https://www.regulations.gov/docketBrowser?rpp=25&so=DESC&sb=commentDueDate&po=0&dct=PS&D=OCC-2017-0014.* Letter from BOK Financial can be accessed directly at *https://www.regulations.gov/document?D=OCC-2017-0014-0016.*

[786] *See* 2013 rule § ■■.5(b)(2)(ii).

[787] *See* 2013 rule § ■■.5(c)(1).

[788] *See* 2013 rule § ■■.5(c)(3). *See also* 2013 rule § ■■.20(b)(6).

[789] *See* 2013 rule § ■■.6(e).

exchange or similar trading facility, and is promptly cleared and settled through a central counterparty.[790]

(5) Covered Funds

The 2013 rule generally defines covered funds as issuers that would be investment companies but for section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 and then excludes specific types of entities from the definition. As described above, the 2013 rule provides for market making and hedging exemptions to the prohibition on proprietary trading. However, the 2013 rule places additional restrictions on the amount of underwriting, market making, and hedging a banking entity can engage in when those transactions involve covered funds. For underwriting and market making transactions in covered funds, if the banking entity sponsors or advises a covered fund, or acts in any of the other capacities specified in § ■ ■.11(c)(2) of the 2013 rule, then any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making-related activities for that particular covered fund must be included in the per-fund and aggregate covered fund investment limits in § ■ ■.12 of the 2013 rule and is subject to the capital deduction provided in § ■ ■.12(d) of the 2013 rule.[791] Additionally, a banking entity's aggregate investment in all covered funds is limited to 3% of a banking entity's tier 1 capital, and banking entities must include all ownership interests in covered funds acquired or retained in connection with underwriting and market making-related activities for purposes of this calculation.[792] Moreover, under the 2013 rule, the exemption for risk-mitigating hedging activities related to covered funds is available only for transactions that mitigate risks associated with the compensation of a banking entity employee or an affiliate that provides advisory or other services to the covered fund.[793]

Under the 2013 rule, foreign banking entities can acquire or retain an ownership interest in, or act as sponsor to, a covered fund, so long as those activities and investments occur solely outside of the United States, no ownership interest in such fund is offered for sale or sold to a resident of the United States (the marketing restriction), and certain other conditions are met. Under the 2013 rule, an activity or investment occurs solely outside of the United States if (1) the banking entity is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or established under the laws of the United States or of any state; (2) the banking entity (and relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any state; (3) the investment or sponsorship, including any risk-mitigating hedging transaction related to an ownership interest, is not accounted for as principal by any U.S. branch or affiliate; and (4) no financing is provided, directly or indirectly, by any U.S. branch or affiliate. In addition, the staffs of the agencies have issued FAQs concerning the requirement that no ownership interest in such fund is offered for sale or sold to a resident of the United States.[794]

(6) Compliance Program

For compliance purposes, the 2013 rule differentiates banking entities on the basis of certain thresholds, including the amount of the banking entity's consolidated trading assets and liabilities and total consolidated assets. More specifically, U.S. banking entities that have, together with affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which—on a worldwide consolidated basis, over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters—equals $10 billion or more are subject to reporting requirements of Appendix A under the 2013 rule. Banking entities that have $50 billion or more in total consolidated assets as of the previous calendar year end and banking entities with over $10 billion in consolidated trading assets and liabilities are subject to the requirement to adopt an enhanced compliance program pursuant to Appendix B of the 2013 rule. Additionally, banking entities that engage in covered activities and that have total consolidated assets of $10 billion or less as reported on December 31 of the previous 2 calendar years qualify for the simplified compliance regime.

The 2013 rule emphasized the importance of a strong compliance program and sought to tailor the compliance program to the size of banking entities and the size of their trading activity. As noted in the preamble to the 2013 rule, the agencies believed it was necessary to balance compliance burdens posed on smaller banking entities with specificity and rigor necessary for large and complex banking organizations facing high compliance risks. As a result, the compliance regime under the 2013 rule is progressively more stringent with the size of covered activities and/or balance sheet of banking entities.

Under the 2013 rule, all banking entities with covered activities must develop and maintain a compliance program that is reasonably designed to ensure and monitor compliance with section 13 of the BHC Act and the implementing regulations. The terms, scope, and detail of the compliance program depend on the types, size, scope, and complexity of activities and business structure of the banking entity.[795]

Under the 2013 rule, banking entities that qualify for the simplified compliance program (banking entities that have total consolidated assets of less than $10 billion) are able to incorporate compliance with the 2013 rule into their regular compliance policies and procedures by reference, adjusting as appropriate given the entities' activities, size, scope, and complexity.[796]

All other banking entities with covered activities are, at a minimum, required to implement a six-pillar compliance program. The six pillars include (1) written policies and procedures reasonably designed to document, describe, monitor and limit proprietary trading and covered fund activities and investments for compliance; (2) a system of internal controls reasonably designed to monitor compliance; (3) a management framework that clearly delineates responsibility and accountability for compliance, including management review of trading limits, strategies, hedging activities, investments, and incentive compensation; (4) independent testing and audit of the effectiveness of the compliance program; (5) training for personnel to

[790] *See* 2013 rule § ■ ■.6(e)(3).

[791] *See* 2013 rule § ■ ■.12(a)(2)(ii); *see also* § ■ ■.11(c)(2).

[792] *See* 2013 rule § ■ ■.12(a)(2)(iii); *see also* § ■ ■.11(c)(3).

[793] *See* 2013 rule § ■ ■.13(a).

[794] *See* Responses to Frequently Asked Questions Regarding the Commission's Rule under Section 13 of the Bank Holding Company Act, June 10, 2014, updated March 4, 2016, available at *https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm.*

[795] *See* 2013 rule § ■ ■.20(a).

[796] *See* 2013 rule § ■ ■.20(f). Note that if an entity does not have any covered activities, it is not required to establish a compliance program until it begins to engage in covered activity.

effectively implement and enforce the compliance program; and (6) recordkeeping sufficient to demonstrate compliance.[797]

In addition, under the 2013 rule, banking entities with covered activities that do not qualify as those with modest activity (banking entities that have total consolidated assets in excess of $10 billion) and that are either subject to the reporting requirements of Appendix A or have more than $50 billion in total consolidated total assets as of the previous calendar year end are required to comply with the enhanced minimum standards for compliance as specified in Appendix B of the 2013 rule.[798]

Appendix B requires the compliance program of the banking entities that are subject to it to (1) be reasonably designed to supervise the permitted trading and covered fund activities and investments, identify and monitor the risks of those activities and potential areas of noncompliance, and prevent prohibited activities andinvestments; (2) establish and enforce appropriate limits on the covered activities and investments, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and the 2013 rule; (3) subject the compliance program to periodic independent review and testing and ensure the entity's internal audit, compliance, and internal control functions are effective and independent; (4) make senior management and others accountable for the effective implementation of the compliance program, and ensure that the chief executive officer and board of directors review the program; and (5) facilitate supervision and examination by the agencies.

Additionally, under the 2013 rule, any banking entity that has more than $10 billion in total consolidated assets as reported in the previous 2 calendar years is required to maintain additional records related to covered funds. In particular, a banking entity must document the exclusions or exemptions relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund, including documentation that supports such determination; for each seeding vehicle that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company, the period of time during which the vehicle will operate as a seeding vehicle, and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified.[799]

(7) Metrics

Under Appendix A of the 2013 rule, banking entities with trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which—on a worldwide consolidated basis, over the four previous quarters, as measured by the last day of each of the four prior calendar quarters—equals or exceeds $10 billion to meet requirements concerning recording and reporting certain measurements for each trading desk engaged in covered trading activity.[800] Banking entities subject to Appendix A are required to record and report the following quantitative measurements for each trading day and for each trading desk engaged in covered trading activities: (i) Risk and Position Limits and Usage; (ii) Risk Factor Sensitivities; (iii) Value-at-Risk and Stress Value-at-Risk; (iv) Comprehensive Profit and Loss Attribution; (v) Inventory Turnover; (vi) Inventory Aging; and (vii) Customer-Facing Trade Ratio.

The metrics reporting requirements are intended to assist banking entities, the SEC, and other regulators in achieving the following: A better understanding of the scope, type, and profile of covered trading activities; identification of covered trading activities that warrant further review or examination by the banking entity to verify compliance with the rule's proprietary trading restrictions; evaluation of whether the covered trading activities of trading desks engaged in permitted activities are consistent with the provisions of the permitted activity exemptions; evaluation of whether the covered trading activities of trading desks that are engaged in permitted trading activities (*i.e.,* underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies; identification of the profile of particular covered trading activities of the banking entity, and its individual trading desks, to help establish the appropriate frequency and scope of the SEC's examinations of such activity; and the assessment and addressing of the risks associated with the banking entity's covered trading activities.[801]

Under the 2013 rule, banking entities with significant trading assets and liabilities (Group A entities) and with moderate trading assets and liabilities (Group B entities) that have less than $50 billion in consolidated trading assets and liabilities are required to report metrics for each quarter within 30 days of the end of that quarter. In contrast, Group A and Group B banking entities with total trading assets and liabilities equal to or above $50 billion are required to report metrics more frequently—each month within 10 days of the end of that month.[802]

ii. EGRRCPA and Conforming Amendments

In accordance with section 203 of EGRRCPA,[803] the agencies amended the definition of ''insured depository institution'' in § ■ ■.2(r) of the 2013 rule to exclude an institution if it, and every entity that controls it, has both (1) $10 billion or less in total consolidated assets and (2) total consolidated trading assets and liabilities that are 5% or less of its total consolidated assets. The agencies also amended the 2013 rule to reflect the changes made by section 204 of EGRRCPA. That provision modified section 13 of the BHC Act to permit, in certain circumstances, bank-affiliated investment advisers to share their name with the hedge funds or private equity funds they organize and offer.

As discussed elsewhere,[804] certain SEC-regulated entities, such as dealers and RIAs, fell under the definition of ''banking entity'' for the purposes of section 13 of the BHC Act before the enactment of EGRRCPA and qualified for the final amendments implementing

[797] *See* 2013 rule § ■ ■.20(b).

[798] *See* 2013 rule § ■ ■.20(c) and Appendix B.

[799] *See* 2013 rule § ■ ■.20(e).

[800] *See* 2013 rule § ■ ■.20(d) and Appendix A.

[801] *See* 2013 rule § ■ ■.20 and Appendix A.

[802] *See* 2013 rule § ■ ■.20(d)(3).

[803] Specifically, section 203 of EGRRCPA provides that the term ''insured depository institution,'' for purposes of the definition of ''banking entity'' in section 13(h)(1) of the BHC Act (12 U.S.C. 1851(h)(1)), does not include an insured depository institution that does not have, and is not controlled by a company that has (1) more than $10 billion in total consolidated assets; and (2) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5% of total consolidated assets.

[804] *See* EGRRCPA Conforming Amendments Adopting Release, 84 FR at 35008.

sections 203 and 204 of EGRRCPA.[805] Therefore, the economic baseline against which the SEC is assessing the final rule incorporates the economic effects of sections 203 and 204 of EGRRCPA, as analyzed in the agencies' release adopting the conforming amendments.[806]

b. Response to Commenters Regarding Economic Baseline and Effects of Section 13 of the BHC Act and the 2013 Rule

In the proposal, the SEC described the baseline effects of the 2013 rule [807] and recognized that amendments that increase or decrease the scope of permissible activities may magnify or attenuate the baseline economic effects of the 2013 rule.[808] The SEC also noted that amendments that decrease (or increase) compliance program and reporting obligations could alter the economic effects toward (or away from) competition, trading activity, and capital formation on the one hand, and against (or in favor of) regulatory and internal oversight on the other. However, the SEC noted that the proposed amendments may enhance trading liquidity and capital formation and that some of the proposed changes need not reduce the efficacy of the regulation or the agencies' regulatory oversight.[809]

A number of commenters, however, have indicated that the proposed amendments would have changed the scope of permissible activities and the compliance regime in the 2013 rule in a manner that significantly alters the costs and benefits of that rule and offered a variety of assessments of the baseline economic effects of section 13 of the BHC Act and the 2013 rule.[810] In response to those comments, this section expands the discussion of the baseline and supplements the analysis in the proposal with a discussion of the comments received by the agencies and, in response to comments, recent research on that topic. In the 2013 rule, the agencies sought to increase the safety and soundness of banking entities and to promote financial stability,[811] and to reduce conflicts of interest between banking entities and their customers, clients, and counterparties,[812] while preserving the provision of valuable client-oriented services [813] and mitigating unnecessary compliance burdens and related competitive effects.[814] Accordingly, the sections that follow address the SEC's understanding of the baseline effects of section 13 of the BHC Act and the 2013 rule on (a) risk exposures, (b) conflicts of interest between banking entities and their customers and counterparties, (c) client-oriented financial services and market quality, and (d) compliance burdens and competition.

The SEC's analysis of these various effects reflects comments received, academic research, and the SEC's experience overseeing registered entities for purposes of section 13 of the BHC Act. Importantly, research studies cited below are limited to their specific settings and are subject to various methodological and measurement limitations, as discussed in the sections that follow. Moreover, as described below, some studies empirically examine the relevant effects around the implementation of the 2013 rule, while others focus on the anticipatory response of market participants around the enactment of section 13 of the BHC Act and prior to the effective date of the 2013 rule. As a result, the SEC recognizes that these findings may have limited generalizability and may or may not extend to various groups of SEC registrants.

As discussed below, some research suggests that section 13 of the BHC Act and the 2013 rule may have reduced risk exposures of banking entities related to trading, but may not have reduced the overall exposure to risk of some banking entities. Other research suggests that the 2013 rule may have partly mitigated certain conflicts of interest between banking entities and clients in a limited set of banking entity-client relationships. Moreover, some research suggests that the 2013 rule imposed large compliance costs that may have disproportionately affected smaller banking entities and may have decreased the willingness and ability of banking entities to engage in certain client facilitation activities.

In addition, commenters suggested that the agencies must consider the effects of the 2013 rule and proposed amendments in light of the overall effects of new requirements on banking entities, including Basel III, regulations of systemically important financial institutions, the SEC's money market reform, and the liquidity coverage ratio.[815] Where relevant, the analysis that follows discusses the direct effects of section 13 of the BHC Act, the 2013 rule, sections 203 and 204 of EGRRCPA and conforming amendments, and the final rule, as well as how they may interact with the effects of other related financial regulations.

i. Risk Exposure

As discussed in the proposal, in implementing section 13 of the BHC Act, the agencies sought to increase the safety and soundness of banking entities and to promote financial stability, among other things.[816] The regulatory regime created by the 2013 rule was intended to enhance regulatory oversight and compliance with the substantive prohibitions in section 13 of the BHC Act.[817]

In response to the proposal, some commenters indicated that the benefits from the statutory prohibition in section 13 of the BHC Act and implementing rules on proprietary trading include reduced banking profits resulting from proprietary trading and corresponding reductions in the costs associated with bailouts; [818] prudent risk management that makes job-creating functions of banks more viable; [819] greater financial stability; [820] dampened bubbles in products such as synthetic collateralized debt obligations,[821] and reduced highly risky bank trading activities and hedge fund and private equity investments that can threaten financial stability.[822] Other commenters stated that proprietary trading was not the cause of the 2007–2008 financial crisis and that almost every financial crisis in history has been driven by classic extensions of credit; [823] that rather than reducing systemic risk, section 13 of the BHC Act and the implementing rules harm the healthy functioning of the financial services

805 The SEC continues to believe that all bank-affiliated entities that may register with the SEC as security-based swap dealers and major security-based swap participants were unaffected by section 203 of EGRRCPA or the conforming amendments because of the size of their balance sheets and the amount of trading activity of their affiliated banking entities. The SEC's analysis was based on DTCC Derivatives Repository Limited Trade Information Warehouse (TIW) data on single-name credit-default swaps.

806 *See* EGRRCPA Conforming Amendments Adopting Release, 84 FR at 35008.

807 *See* 83 FR at 33520–33521.

808 *See* 83 FR at 33521.

809 *Id.*

810 *See, e.g.,* Occupy the SEC, Better Markets, SIFMA, Center for American Entrepreneurship.

811 *See, e.g.,* 79 FR at 5666, 79 FR at 5574, 79 FR at 5541.

812 *See, e.g.,* 79 FR at 5659.

813 *See, e.g.,* 79 FR at 5541.

814 *See, e.g.,* 79 FR at 5541, 79 FR at 5584, 79 FR at 5616, 79 FR at 5671, 79 FR at 5673, 79 FR at 5675, 79 FR at 5713.

815 *See* CCMC; Oonagh McDonald; JBA; Occupy the SEC and Systemic Risk Council.

816 *See, e.g.,* 79 FR at 5666, 79 FR at 5574, 79 FR at 5541, 79 FR at 5659. *See also* Senators Merkley et al.

817 *See, e.g.,* 83 FR at 33520.

818 *See, e.g.,* Occupy the SEC.

819 *Id.*

820 *See, e.g.,* Better Markets and NAFCU.

821 *See, e.g.,* Volcker Alliance.

822 *See, e.g.,* CAP.

823 *See, e.g.,* American Action Forum.

industry; [824] and that section 13 of the BHC Act and the implementing rules are no longer necessary given Basel III capital requirements, stress testing, and liquidity coverage ratio rules that promote short-term resilience of bank risk profiles.[825]

In response to the comments discussed above, the SEC has analyzed relevant academic research on these issues. Most existing qualitative analysis and quantitative research on moral hazard,[826] incentives to increase risk exposures that arise out of deposit insurance [827] and implicit bailout guarantees,[828] and systemic risk implications of proprietary trading do not explicitly analyze the effects of section 13 of the BHC Act or of the 2013 rule.[829]

Several recent academic studies examined the baseline effects of section 13 of the BHC Act and implementing regulations on activities by banking entities that involve market risk. As discussed in detail below, this research suggests that, although section 13 of the BHC Act and the 2013 rule may have reduced risk exposure related to trading, it is not clear that the 2013 rule reduced the overall risk of individual banking entities and potentially of banking entities as a whole.

For example, one study [830] compares changes in equity returns and CDS spreads of 93 U.S. listed banks affected by post-crisis financial reforms and of those that were not. Specifically, the study finds that news concerning the potential enactment of substantive prohibitions in section 13 of the BHC Act [831] led to a rise in credit default swap (CDS) spreads (by as much as 17–18 basis points) and to a decrease in equity prices (statistically significant in most specifications). The paper interprets the results as an indication that the proprietary trading prohibition reduced bank profitability because of the spinoffs of profitable trading and swap desks. In an additional analysis, the paper finds that these effects were more significant for investment banks, for banks that are more likely to be systemically important,[832] and for banks that are closer to default. Notably, the paper does not examine changes in specific types of risky activities, so it is possible that the observed effects may have occurred for reasons unrelated to the proprietary trading prohibitions.[833] While the paper concludes that the reforms reduced bail-out expectations, the rise in CDS spreads and the decrease in equity prices are also consistent with the interpretation that market participants reacted to the event as a change increasing the risk to banking entities, for instance because of the expected shift to risk taking through lending or reduced hedging of lending activities with trading activities. For instance, a shift away from trading activity and toward more illiquid and potentially less diversified lending or trading activities may have increased banking entities' exposure to liquidity and counterparty risks, and this risk may have been priced in higher CDS spreads of banking entities.

In contrast, another paper [834] examines the cumulative market reaction to 15 events related to section 13 of the BHC Act using a sample of 784 listed banks and seeks to distinguish the events from announcements surrounding Orderly Liquidation Authority events. The paper finds significant negative cumulative abnormal equity returns (¥11.97%) for targeted banks,[835] consistent with targeted banks losing out on profitable opportunities, and positive cumulative abnormal returns (7.1%) for non-targeted banks. Similarly, the paper estimates that targeted banks experienced a 0.021% increase in CDS spreads, consistent with the changes making targeted banks riskier, whereas non-targeted banks experienced a decline in CDS spreads of ¥0.049%. In addition, banks with a higher measure of systemic risk (marginal expected shortfall), higher illiquidity (Amihud (2002) [836] measure and the bid-ask spread), and worse reporting quality (abnormal loan loss provisions) experienced more negative market reactions to events surrounding section 13 of the BHC Act and the 2013 rule. On aggregate, the paper finds that equity returns rose and CDS spreads declined for sample banks, and concludes that the rule targeted larger institutions and enhanced the relative position of smaller banks.

Four factors limit the interpretation of this paper's results. First, the validity of inference from event studies is affected by the presence of confounding events on announcement days. While a study of a greater number of event days may provide a more complete picture of market responses to even minor announcements concerning the reform of interest, it increases the likelihood of confounding events occurring on event days, ceteris paribus. Second, the proprietary trading prohibitions scoped in all, not just a subset of, banking entities, while the paper hypothesizes differential effects of the proprietary trading prohibition on targeted and non-targeted banks. As a result, the measurement of targeted banks may simply be capturing prior performance of an institution during times of severe

[824] *See, e.g.,* American Action Forum and CAP.

[825] *See* Oonagh McDonald. *See also infra* note 849.

[826] A classic definition of moral hazard is ''the loss exposure of an insurer (the FDIC) that results from the character or circumstances of the insured'' (here, the banking entity). *See* Anthony Saunders & Marcia Cornett, Financial Institutions Management: A Risk Management Approach, 573 (8th ed. 2014) p. 573.

[827] Saunders and Cornett (2014) discusses how deposit insurance reduces the risks of depositors or other liability holders engaging in a run on a banking entity and the related costs of a banking entity's failure. However, if the risk of bank failure is not adequately priced in the insurance premium paid by the banking entity, deposit insurance can create incentives to engage in more risky activities. Moreover, even absent deposit insurance, the limited liability of a banking entity's shareholders still creates incentives to risk shift at the expense of depositors, bondholders, and other fixed claimants. *See* Saunders and Cornett (2014), ch. 19.

[828] Deposit insurance and implicit bailout guarantees may give rise to risk taking incentives that are not specific to proprietary trading. In other words, even in the absence of proprietary trading, both deposit insurance and implicit bailout guarantees may create incentives for banking entities to increase risk exposures from permissible activities such as lending, underwriting, and market making. Thus, a prohibition of proprietary trading need not by itself reduce moral hazard or overall risk exposures of banking entities if banking entities increase risk exposures from other activities during the same time.

[829] For a literature review, *see, e.g.,* Sylvain, Benoit et al., *Where the Risks Lie: A Survey on Systemic Risk,* 21 Rev. Fin. 109 (2017). *See also* 83 FR 33533 note 350.

[830] *See* Alexander Schäfer et al., *Financial Sector Reform after the Subprime Crisis: Has Anything Happened?,* 20 Rev. Fin. 77 (2016).

[831] Specifically, the paper performs an event study around January 21, 2010, when President Obama announced support for Volcker Rule-type restrictions on proprietary trading by banking entities. *See* Remarks by the President on Financial Reform, Office of the Press Secretary, The White House, January 21, 2010, available at *https://obamawhitehouse.archives.gov/the-press-office/ remarks-president-financial-reform,* last accessed 6/27/2019.

[832] Specifically, the paper measured systemic importance on the basis of the Financial Stability Board's list of 29 global systemically important financial institutions published on November 4, 2011. *See* Financial Stability Board Identifies 29 Global SIFIs and Announces Agreed Policy Measures, Mondaq, November 4, 2011, last accessed 7/9/2013.

[833] Another study by Gropp et al. (2011) finds that government guarantees can increase risk-taking incentives in competitor, but not in protected, banks. *See* Reint Gropp et al., *Competition, Risk-Shifting, and Public Bailout Policies,* 24 Rev. Fin. Stud. 2084 (2011).

[834] *See* Fayez Elayan et al., *The Impact of the Volcker Rule on Targeted Banks, Systemic Risk, Liquidity, and Financial Reporting Quality,* 96 J. Econ. & Bus. 69 (2018).

[835] The paper defines targeted banks as banks that issued or had exposure to mortgage-backed securities or other securitized products or had other asset write-downs reported in news sources.

[836] *See* Amihud Yakov, *Illiquidity and Stock Returns: Cross-section and Time Series Effects,* 5 J. Fin Markets 31 (2002).

stress or the likelihood of an institution being affected by other regulatory restrictions or sanctions and not necessarily the degree of exposure to the proprietary trading prohibition. Third, since the management of bank balance sheets and risk exposures can take several quarters, narrow event windows may reflect market participants' expectations but may not be informative about ex-post changes in risky bank activities in response to the event.[837] Finally, all but one event considered in this study relate to the substantive prohibitions in section 13 of the BHC Act (and not the agencies' implementing rules), and all of the events examined in this study precede the adoption of the 2013 rule.

A recent paper uses regulatory data on net trading profits reported by bank holding companies to the Federal Reserve under the Market Risk Capital Rule and examines the risk-taking of U.S. banks via trading books before and after the 2013 rule.[838] The paper finds that, prior to 2014, U.S. banks had significant exposures to equity risk factors through their trading books, but that such trading exposures declined after the implementing regulations. The paper also finds that, in response to the 2013 rule, the trading desks of U.S. banks have decreased their exposures to interest rate risk but not to credit risk. Consistent with bank reliance on certain exemptions with respect to commodities, foreign exchange, and currency trading, U.S. banks also continue to be exposed to currency risk. Importantly, post-2013 rule credit and dollar risk exposures are far less significant in magnitude compared to pre-2013 rule exposure to equity risk factors. The paper concludes that the ban on proprietary trading was effective in curtailing large exposures. These results seem to suggest that holding companies significantly reduced their exposure to risk from trading activities.

Four considerations limit the interpretation of these results. First, the paper's tests focus on data aggregated to the weekly frequency, and it is not clear if the results would continue to hold using daily, monthly, or quarterly frequencies. For example, the results appear inconsistent with other research analyzing FR Y–9C data on trends in quarterly trading positions and trading revenues, which does not find significant changes in equity profits and losses after the 2013 rule.[839] Second, anticipatory compliance and confounding regulatory and macroeconomic events (unaccounted for in the paper) complicate definitive causal inference. Third, the paper does not examine the possibility that, since higher risk is generally compensated with higher expected returns,[840] banking entities may have offset risk reductions in their trading books by shifting risk into illiquid banking books. Fourth, the paper also does not test changes in the total amount of risk on bank balance sheets before and after the relevant regulatory shocks or consider the effects of the implementing regulations on the overall risk of U.S. banking entities.

Another study empirically examines the effects of the substantive prohibitions of section 13 of the BHC Act on the returns and overall risk of publicly traded U.S. bank holding companies before and after the third quarter of 2010.[841] Consistent with the papers discussed above, this paper finds that most affected bank holding companies, *i.e.* those with the largest trading books before 2010, reduced trading books relative to total assets by 2.34% more than other bank holding companies. However, this result is generally consistent with mean reversion in trading activity by banks that may have suffered the greatest trading losses during the crisis. In addition, the paper does not directly distinguish between proprietary trading and client facilitation trading or hedging trading. Although the paper finds a decline in trading activity and a general decline in overall bank risk (measured by the *z-score*),[842] the paper does not find a pronounced effect on most affected bank holding companies; in fact, some of the results suggest that most affected banks became riskier than less affected banks. The paper finds that the channel for this effect on overall risk is an increase in asset return volatility of affected bank holding companies. In addition, the paper finds no significant differences in the volatility of bank stock prices and liquidity ratios of affected and unaffected entities. The paper concludes that the risk taking incentives of banking entities have not changed and that affected banks have been able to maintain their levels of risk taking by becoming less likely to use remaining trading assets to hedge banking book returns.[843] The SEC notes that the sample period of the paper ends prior to the full effective date of the 2013 final rule, which may partly limit the interpretation of these results.

Another recent paper [844] uses structural methods to isolate and estimate the effects of the limitation of bank proprietary trading in section 13 of the BHC Act on the probability of bank defaults, earnings, and the value of their equity. Using a model calibrated to the data from a sample of 34 of the most affected U.S. banks, this paper finds that banks—and particularly banks most affected by section 13 of the BHC Act—

[837] For example, see the below discussion of a study by Keppo and Korte (2018) examining changes in bank risk taking over a 10 quarter period and finding that banks did not decrease risk-taking.

[838] *See* Antonio Falato et al., ''Banks as Regulated Traders,'' Finance Fin. & Econ. Discussion Series 2019–005, Washington: Board of Governors of the Fed. Reserve System (2019), *available at https://doi.org/10.17016/FEDS.2019.005,* last accessed 5/20/2019.

[839] *See* Begenau, 2019, Discussion of ''Banks as Regulated Traders,'' NBER CF Spring meeting, April 12, available at *https://begenau.people.stanford.edu/sites/g/files/sbiybj1926/f/nber_cfspring2019_begenau_disc.pdf,* last accessed 07/15/2019. *See also* Juliane Begenau et al., *Banks' Risk Exposures,* (Nat'l Bureau of Econ. Research, Working Paper No. 21334, 2015) *available at http://www.nber.org/papers/w21334,* last accessed 07/15/2019.

[840] This effect is commonly known as the ''risk-return tradeoff'': If an investor is willing to take on risk, there is a reward of higher expected returns. *See* ZVI Bodie et al., Investments, G–11 (9th ed. 2011).

[841] *See* Jussi Keppo & Josef Korte, *Risk Targeting and Policy Illusions—Evidence from the Announcement of the Volcker Rule,* 64 Mgmt. Sci. 215 (2018). Also cited as an example of ''pathbreaking work assessing the many costs and benefits of the Rule'' in Robert J. Jackson Jr., ''Proposed Amendments to the Volcker Rule,'' Securities and Exchange Commission, June 5, 2018, note 21 available at *https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-volcker-rule.*

[842] The z-score is one of the most popular multiple discriminant analysis models of bankruptcy, originally developed by Altman (1968) and updated frequently since. Multiple discriminant analysis consists of identifying a linear combination of accounting measures that provides the best fit for the observed default and non-default outcomes in a particular sample of firms. The variables that enter into the z-score include: The ratio of working capital to total assets; retained earnings to total assets; earnings before interest and taxes to total assets; market value of equity to total liabilities; and net sales to total assets. While the weights on these components of the z-score are periodically recalibrated using more recent samples, all components enter with a positive sign, such that an increase in each of the variables decreases the probability of bankruptcy. *See* Phillippe Jorion, GARP Financial Risk Manager Handbook: Frm Part I/Part II, 475 (2011).

[843] In another context, Keppo and Korte (2018) also find that, after the passage of the Gramm-Leach-Bliley Act that repealed the Glass-Steagall Act, the overall risk (measured by the z-score) of affected banks relative to unaffected banks did not change. In that context, the paper finds that affected banks did significantly increase their trading risk and decrease the risk of their banking book.

[844] *See* Sohhyun Chung et al., *The Impact of Volcker Rule on Bank Profits and Default Probabilities,* (SSRN Working Paper, Feb. 27, 2019), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2167773,* last accessed 4/23/2019

Also cited in Robert J. Jackson Jr., ''Proposed Amendments to the Volcker Rule,'' Securities and Exchange Commission, June 5, 2018, note 22 available at *https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-volcker-rule.*

may have become riskier after the statutory change. In the model, the key mechanism behind this effect is the banks' ability to respond to shocks: Since the rule leads to a reduction in the size of the trading book and increases the relative weight of an illiquid banking book, banks face greater difficulties scaling down the bank book when faced with negative earnings shocks after the rule. The model assumes no implementation costs, as the costs were sunk when the statutory prohibition came into effect and yields an estimate of between ¥0.72% and 56.72% increase in average bank default probability after the law. This estimate range may suggest that the overall risk of some banks may have increased, in some cases, after the law. In the model, banks for which a small trading book is optimal, banks with a profitable and low-risk bank book, and banks that take more risk through leverage, do not experience this rise in the default risk after the proprietary trading prohibition. Because the banking book is more profitable and volatile than the trading book for most affected banks, the paper actually estimates no significant decrease and, in some cases, an increase in banks' expected earnings and earnings volatility (a range of ¥0.04% to 0.73% depending on calibration).[845] An important caveat for the interpretation of these results is the sensitivity of the estimates to modeling assumptions, the limited sample used in model calibration, and the extremely broad range of estimates of an increase in average bank default probability after the law.

Finally, a recent paper [846] identified three potential channels behind the effects of section 13 of the BHC Act and the 2013 rule on risky activities of bank holding companies: (i) Risks from proprietary trading activity itself, (ii) risk from a lack of diversification of bank revenue (trading and non-trading revenue), and (iii) risk from similarity among banks. The paper measures overall risk with the z-score (as well as volatility in returns, revenues, and returns on assets) and systemic risk with marginal expected shortfall (average stock return of each bank holding company during bottom 5th percentile shocks to 1-year market returns; it also measures marginal expected shortfall for the financial industry, and tail beta) [847] and documents two main results. First, an index of bank revenue diversification reduces measures of bank and systemic risk, while similarity across banks increases systemic risk, and trading activity increases both. Second, the 2013 rule reduced risks from trading activity of affected banks, reduced the diversification of bank revenue of affected banks, and increased similarity across banks.

The interpretation of these results may be limited because of respective methodologies, measurement, identifying assumptions, and residual confounding, as well as the general limitations noted at the outset. However, these results are broadly consistent with other research that finds that banking entities can respond to regulations by risk shifting within an asset class while remaining in compliance [848] and that the implementation of other financial reforms can create effects inconsistent with the regulators' intentions.[849]

Some commenters indicated that restricting pay practices of banking entities may effectively reduce proprietary trading cross-subsidized by taxpayers and accordingly lower the risks of banking entities.[850] While the final rule does not amend existing requirements or impose new requirements related to compensation practices of banking entities, the SEC notes two incentive effects relevant for the consideration of these issues. First, as discussed above, proprietary trading is one of many activities through which a banking entity can take risk. Both deposit insurance and implicit government bailout guarantees incentivize risk taking that is not specific to proprietary trading. Even in the absence of proprietary trading, deposit insurance and implicit bailout guarantees may lead banking entities to take greater risks through lending and permitted underwriting and market making, among other things. As a result, a prohibition on proprietary trading need not by itself reduce the overall risk of banking entities if banking entities increase risk through other activities during the same time.

Second, the incentives to take on greater risks described above are those of both a banking entity's shareholders who are residual claimants on the banking entity's assets and management. Under limited liability, all shareholders enjoy a limited downside (at worst, shareholders stand to lose their investment) and an unlimited upside if the firm performs well (the value of shareholders' equity depends on the value of the assets net of the value of fixed claims, such as claims of debtholders, depositors, and employees).[851] Thus, the incentives of banking entities to take on greater risks discussed above may persist so long as any restrictions on pay practices leave the incentives of a banking entity's management and employees even partly aligned with those of shareholders.

ii. Conflicts of Interest

As discussed in the proposal, in implementing section 13 of the BHC Act, the agencies also sought to reduce conflicts of interest between banking entities and their customers.[852] Some commenters indicated that bank trading activities and interests in hedge funds and private equity funds resulted in

[845] The estimate of ¥0.04% was obtained using parameters for ''median hedge fund banks,'' calculated as the median of the 34 sample banks, for which the drift and volatility of the trading earnings were estimated from Credit Suisse Long/Short Equity Hedge Fund Index data for 2000 through the beginning of 2010. The estimate of 0.73% was obtained using drift and trading earnings volatility for an asset-weighted mean of sample banks.

[846] *See* Christina Bui and Talis Putnins, *The Intended and Unintended Effects of the Volcker Rule,* (Aug. 31, 2018) (working paper), *available at http://fmaconferences.org/SanDiego/Papers/Volcker_SubmissionFMA.pdf,* last accessed 4/23/2019.

[847] Acharya et al. (2017) finds that a bank's impact on systemic expected shortfall is affected by its marginal expected shortfall and leverage. *See* Viral Acharya et al., *Measuring Systemic Risk,* 30 Rev. Fin. Stud. 2 (2017).

[848] *See* Ran Duchin and Denis Sosyura, *Safer Ratios, Riskier Portfolios: Banks' Response to Government Aid,* 113 J. Fin. Econ. 1 (2014).

[849] For example, Sundaresan and Xiao (2019) show that the interaction of liquidity requirements of Basel III and the money market fund reform may have increased the reliance of private financial institutions on liquidity provided by Federal Home Loan Banks that enjoy an implicit government guarantee. The paper concludes that the rules increased the role of a government-sponsored enterprise in the aggregate liquidity transformation and the reliance of private institutions on public liquidity backstops. In another context, Baghai et al. (2019) finds that following the money market fund reforms, safer funds exited the industry, the remaining funds increased their portfolio risk, and issuers with lower credit risk experienced a reduced access to money market funding. *See* Suresh Sundaresan and Kairong Xiao, *Unintended Consequences of Post-Crisis Liquidity Regulation* (Aug. 9, 2019) (working paper) *last accessed* 8/29/2019. *See also* Ramin Baghai et al., *Liability Structure and Risk-Taking: Evidence from the Money Market Fund Industry,* (Aug. 18, 2019) (working paper) last accessed 8/29/2019.

[850] *See, e.g.,* CAP and Public Citizen, citing Robert J. Jackson Jr., ''Proposed Amendments to the Volcker Rule,'' Securities and Exchange Commission, June 5, 2018, available at *https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-volcker-rule* on potential effects of pay practices on proprietary trading.

[851] *See, e.g.,* Jonathan Berk & Peter DeMarzo, Corporate Finance, 552–53 (3rd ed. 2014), discussing how leverage can (1) incentivize shareholders to shift from lower-risk to higher-risk assets (the ''asset substitution'' problem); and (2) induce shareholders to undertake negative net present value, but sufficiently risky projects (the ''over-investment'' problem). *See also* Michael Jensen and William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* 3 J. Fin. Econ. 305 (1976).

[852] *See, e.g.,* 79 FR at 5659.

significant conflicts of interest between banks and their customers.[853] One commenter also indicated that the agencies should amend the provisions concerning material conflicts of interest by permitting banking entities to rely on information barriers under certain circumstances.[854]

In response to these comments, the SEC reviewed relevant research on conflicts of interest between banking entities and their customers. As discussed below, related research generally examines trading of banking entities in stocks, bonds, or options of their advisory and underwriting clients. While the findings are somewhat mixed and limited to their specific empirical settings, this research is consistent with the presence of such conflicts in certain groups of merger and acquisition (M&A) deals. In addition, one study finds that a narrow type of conflicts of interest between banking entities and their clients may have decreased after the implementation of the 2013 rule.

Specifically, a recent study[855] examines both the presence of conflicts of interest between advisor banks and their customers based on banks' options holdings, and changes in such trading activity around the implementation of the Volcker Rule. The paper documents three main results. First, the paper finds that merger advisors tend to increase their holdings in call options relative to put options in merger targets during the quarter before the announcement. Second, merger advisors are significantly more likely to increase put option holdings in the acquirer firm.[856] In combination with the literature's general finding of average negative announcement returns in acquirer firms and positive announcement returns in target firms, the paper argues that these results are suggestive of informed trading by advisor banks on client firms. Third, within the subsample of affected deals (deals in which one or more advisor banks ceased proprietary trading operations around the enactment of section 13 of the BHC Act) after 2011, the paper finds that advisors did not increase their net call option holdings on target firms before merger announcements. The paper concludes that, in this narrow setting, the Volcker Rule may have decreased banks' options trading on client information. Importantly, the paper finds that some of this bank activity was replaced by hedge fund activity: Specifically, hedge funds increased their informed trading in options of M&A client firms around the same time in the same subsample of deals.

The SEC is also aware of a broader body of research that empirically tests the existence and magnitude of conflicts of interest between banks and their customers in the context of advising and underwriting relationships and that does not directly empirically test the effects of section 13 of the BHC Act or the 2013 rule on the presence or magnitude of such conflicts. One article in the legal literature[857] empirically measures the profitability of trading by banks that have advisory clients and are subject to reporting requirements as temporary insiders. They document that such trading by banks in the stocks of advisory clients is profitable (with an estimated average 25% return on their trades), that the trading centers around adverse events, and that the elimination of Glass-Steagall restrictions in 2002 was associated with more frequent and more profitable trading. However, the paper does not empirically test the effects of section 13 of the BHC Act or of the 2013 rule.

Finance research on this type of conflict of interest between banks and their customers finds mixed effects. One of the earlier papers[858] examines trading in M&A target firms by the advisor banks of bidders and links advisor pre-announcement stakes in target firms with the probability of deal success and with the target premium. They document positive returns of this trading strategy and conclude that advisors acquire positions in deals of their advisory clients, as well as influence deal outcomes. Since such advisor behavior benefits the bidder, the authors recognize that they cannot rule out the alternative explanation that the bidder's board retains the advisor with strong incentives for deal completion. Outside of the M&A context, other work[859] explores the trading activity of IPO underwriters and finds that lead underwriter trades in IPO firms are associated with subsequent IPO abnormal returns.

Another study[860] focuses on bond trading and uses a sample covering 1994 through 2006 to examine the trading of bond dealers affiliated with M&A advisory banks with insurance companies. The study finds weak evidence that when affiliated dealers are one side of a bond transaction, they earn higher bond returns than unaffiliated dealers, and that affiliated dealers sell more of the bonds that may lose value ahead of bad news than unaffiliated dealers. The paper observes only a subset of such dealer trades with insurance companies and is unable to evaluate whether affiliated dealers are net buyers or sellers of affected bonds before bad news. The study concludes that there is weak and suggestive evidence that transfer of information within financial institutions is one of the potential information sources before public announcements.

Similarly, another paper[861] finds no evidence of information leakage because of investment bank M&A advisory, underwriting, or lending relationships from 1997 through 2002. Specifically, the paper finds no evidence that investment bank clients buy shares in takeover targets in advised deals. Similarly, bank clients with previous underwriter or lending relationships do not trade or earn abnormal returns before earnings announcements. The paper also examines market making imbalances and investment returns by connected brokerage houses and finds that they do not trade profitably ahead of earnings announcements by their IPO, SEO, M&A client, or borrower firms. The paper concludes that neither brokerage houses nor their clients trade on inside information available to the brokerage because of their market making or advising roles.

The SEC continues to note that the above studies are limited to their specific empirical settings and, as can be seen above, different empirical design, measurement, and identification approaches limit inference in each of the papers discussed above. Moreover, the SEC continues to note that the scope of this economic analysis is limited to SEC registrants, investors in securities markets, and the functioning of securities markets. While the research discussed above does not focus

[853] *See, e.g.,* CAP.

[854] *See* SIFMA.

[855] *See* Michelle Lowry et al., *Informed Trading By Advisor Banks: Evidence from Options Holdings,* 32 Rev. Fin. Stud 605 (2018).

[856] To the degree that some advisor banks may have an underlying (long) risk exposure to acquirer firms' equity, buying put options is also consistent with risk-mitigating hedging.

[857] *See* Sureyya Avci et al., *Eliminating Conflicts of Interests in Banks: The Significance of the Volcker Rule,* 35 Yale J. Reg. 343 (2017). Also cited in Robert J. Jackson Jr., ''Proposed Amendments to the Volcker Rule,'' Securities and Exchange Commission, June 5, 2018, note 20, available at *https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-volcker-rule.*

[858] *See* Andriy Bodnaruk et al., *Investment Banks as Insiders and the Market for Corporate Control,* 22 Rev. Fin. Stud. 4989 (2009).

[859] *See* Yao-Min Chiang et al., *The Information Advantage of Underwriters in IPOs,* Mgmt. Sci. (forthcoming 2019).

[860] *See* Semi Kedia and Xing Zhou, *Informed Trading Around Acquisitions: Evidence From Corporate Bonds,* 18 J. Fin. Mkt. 182 (2014).

[861] *See* John M. Griffin et al., *Examining the Dark Side of Financial Markets: Do Institutions Trade on Information from Investment Bank Connections,* 25 J. Fin. Econ. 2155 (2012).

specifically on banking entities that are SEC registrants, some of the incentive effects and conflicts of interest discussed above may extend to banking entities overseen by the SEC.

iii. Client-Oriented Services and Market Quality

In the 2013 rule, the agencies recognized that client-oriented financial services, such as underwriting and market making, are critical to capital formation and can facilitate the provision of market liquidity and that the ability to hedge is fundamental to prudent risk management as well as capital formation.[862]

In the proposal, the agencies stated that compliance with the conditions of the underwriting and market making exemptions under the 2013 rule, such as RENTD, creates ambiguity for some market participants, is over-reliant on historical demand, and necessitates an accurate calibration of RENTD for different asset classes, time periods, and market conditions.[863] Since forecasting future customer demand involves uncertainty, particularly in less liquid and more volatile instruments and products, banking entity affiliated dealers face uncertainty about the ability to rely on the underwriting and market making exemptions. This uncertainty can reduce a banking entity's willingness to engage in principal transactions [864] with customers, which, along with reducing profits, may reduce the volume of transactions intermediated by banking entities.[865]

Moreover, consistent with the views of some commenters,[866] the SEC believes that, as a baseline matter, the 2013 rule creates significant uncertainty among market participants regarding their ability to rely on the risk-mitigating hedging exemption. For example, there may be considerable uncertainty regarding whether a potential hedging activity will continue to demonstrably reduce or significantly mitigate an identifiable risk after it is implemented.[867] Unforeseeable changes in market conditions and other factors could reduce or eliminate the intended risk-mitigating effect of the hedging activity, making it difficult for a banking entity to comply with the continuous requirement that the hedging activity demonstrably reduce or significantly mitigate specific, identifiable risks.[868] According to commenters, uncertainty and compliance burdens related to the risk-mitigating hedging exemption are leading to less timely, less flexible, and less efficient hedging.[869]

The SEC continues to recognize that SEC-regulated entities routinely engage in both static and dynamic hedging at the portfolio (not the transaction) level and monitor and reevaluate on an ongoing basis aggregate portfolio risk exposures, rather than the risk exposure of individual transactions.[870] Dynamic hedging may be particularly common among dealers with large derivative portfolios, especially when the values of these portfolios are nonlinear functions of the prices of the underlying assets (*e.g.,* gamma hedging of options).[871] As a baseline matter, the SEC notes that the 2013 rule permits dynamic hedging. However, the 2013 rule requires the banking entity to document and support its decisions regarding individual hedging transactions, strategies, and techniques for ongoing activity in the same manner as for its initial activities, rather than permitting a banking entity to provide documentation for the hedging decisions regarding a portfolio as a whole.

The agencies have received a number of comments concerning the baseline effects of section 13 of the BHC Act and the 2013 rule on client facilitation activities, hedging, and market quality. The agencies received comments that the 2013 rule maintains the depth and liquidity of U.S. capital markets and that market liquidity remains within historical norms; [872] that there is no clear evidence that the 2013 rule has affected liquidity at a level that should cause concern; [873] and that liquidity may signal a bubble and should not be a key or even a major metric in assessing the effects of reforms.[874] Other commenters stated that the 2013 rule has imperiled valuable market making and risk-mitigating hedging and reduced market liquidity; [875] that the prescriptive nature of the 2013 rule has raised costs of providing liquidity, which has been passed along to investors and may have exacerbated dislocations,[876] and that less liquid capital markets have made it difficult for derivative end-users to raise capital in times of stress.[877]

The role of dealers in market making and client facilitation may be more significant in dealer markets, such as derivative and corporate bond markets. The SEC has elsewhere discussed several key changes in liquidity in bond markets and security-based swaps after the financial crisis. For example, the SEC found that, in corporate bond markets, although estimated average transaction costs have decreased, trading activity has become more concentrated in less complex bonds and bonds with large issue sizes; that transaction costs have increased for some subgroups of corporate bonds; and that dealers have, in aggregate, reduced their capital commitment since its 2007 peak, consistent with the claim that the Volcker Rule and other reforms potentially reduced the liquidity provision in corporate bonds.[878] The SEC recognizes difficulties in causal attribution of the various provisions of section 13 of the BHC Act and the 2013 rule and notes that some studies do not find significant structural breaks associated with post-crisis financial regulations in several measures of market liquidity.[879] However, the SEC continues to be informed by both comments discussed above and a body of research drawing causal inference concerning the adverse effects of section 13 of the BHC Act and the 2013 rule on dealer provision of liquidity and on the risk of market dislocations in times of stress.[880]

Importantly, the 2013 rule included a large number of requirements and provisions, and aspects of the 2013 rule most likely to affect banking entities' client facilitation activity (such as the RENTD requirement for the underwriting and market making exemptions) are not quantifiable or subject to public or regulatory reporting. As a result, existing research primarily seeks to document trends in various aspects of market liquidity in general and the effects of section 13 of the BHC

[862] *See, e.g.,* 79 FR at 5541, 79 FR at 5546, 79 FR at 5561.

[863] *See, e.g.,* 83 FR at 33532.

[864] Dealers can trade as agents, matching customer buys to customer sells, or as principals, absorbing customer buys and customer sells into inventory and committing the necessary capital.

[865] *See, e.g.,* 83 FR at 33532.

[866] *See, e.g.,* ABA.

[867] *See, e.g.,* 83 FR at 33465.

[868] *Id.*

[869] *See, e.g.,* JBA and SIFMA.

[870] *See, e.g.,* 83 FR at 33535.

[871] *Id.*

[872] *See, e.g.,* NAFCU and CAP.

[873] *See, e.g.,* AFR and Occupy the SEC.

[874] *See, e.g.,* Public Citizen.

[875] *See, e.g.,* SIFMA and American Action Forum.

[876] *See, e.g.,* FSF and SIFMA.

[877] *See, e.g.,* Coalition for Derivative End Users.

[878] *See* SEC Report 2017, *supra* note 774, for a detailed data analysis and literature survey.

[879] *See, e.g.,* Francesco Trebbi and Kairong Xiao, 2018, *Regulation and Market Liquidity,* 6 Mgmt. Sci. 1949 (2019). The generalizability of the paper's result is limited by the sample period, which ends in December 2014 and before the full implementation of the 2013 rule. For more methodological limitations of this paper, such as heuristic choices of parameters, and crucial assumptions, as well as other issues, *see* SEC Report 2017, *supra* note 774, at 118–119. *See also* Tobias Adrian et al., *Liquidity, Leverage, and Regulation 10 Years After the Global Financial Crisis,* 10 Ann. Rev. Fin. Econ. 1 (2018).

[880] *Id. See also* 83 FR at 33520–33522, 33532–33533.

Act and the 2013 rule on dimensions of market liquidity in particular. However, the most likely channels for the below effects of section 13 of the BHC Act and the 2013 rule on client facilitation activities are the requirements for the exemptions (such as RENTD) and uncertainty around the ability to rely on exemptions for client facilitation activities.

As discussed below, several studies show significant declines in various measures of liquidity after the financial crisis and post-crisis reforms, including a recent study that ties the effects to the underwriting exemption of the 2013 rule. In addition, some research that reconciles the deterioration in dealer liquidity provision with improvements in price-based measures of liquidity attributes those effects to the reduced willingness of dealers to provide liquidity on a principal basis after implementation of the 2013 rule. Further, existing research suggests that the 2013 rule resulted in reduced liquidity during times of stress, with an increase in liquidity provision by dealers unaffiliated with banks failing to fully offset the reduction in liquidity provision by bank-affiliated dealers. Moreover, some research suggests that post-crisis financial reforms led to persistent deviations from no-arbitrage conditions across markets, with the effect driven by banking entities and levered nonbanking entities that rely on systemically important banking entities for funding liquidity. Finally, new evidence indicates that post-crisis financial regulations may also be having effects on the co-movement in liquidity metrics across markets. Though the research discussed below is unable to attribute observed trends to specific provisions of the 2013 rule, these findings are largely consistent with the claim that the 2013 rule had adverse effects on certain aspects of client facilitation activity by banking entities, as discussed below.

A number of studies documented declines in several dimensions of liquidity after the financial crisis and post-crisis reforms. For example, one study [881] finds that the willingness of dealers to commit capital overnight, turnover, the frequency of block trades, and average trade size have all declined after the financial crisis. Importantly, the paper finds that the shift away from market-makers absorbing customer imbalances and toward agency trading was most acute when banks were required to comply with the proprietary trading prohibition. Further, the paper finds that these declines in dealer provision of liquidity stem from bank-affiliated dealers. The paper concludes that post-crisis banking regulations, including the 2013 rule, contributed to the reductions in turnover, trade size, frequency of block trades, and the willingness of dealers to commit capital.

Another paper [882] examines the cost of immediacy in corporate bonds, using index exclusions as a setting in which uninformed traders exogenously demand immediacy. The paper finds that the cost of immediacy has more than doubled and that dealers revert back to target inventory far more quickly after the 2007–2008 financial crisis. The paper finds that this post-crisis dealer behavior is most severe for bank dealers and concludes that such changes are consistent with the effects of the Volcker Rule.

Research on changes in liquidity around the post-crisis reforms, including the 2013 rule, presents two seemingly contradictory results: On the one hand, price-based measures of liquidity (such as the bid-ask spread) have improved; on the other hand, measures of dealer liquidity supply have significantly worsened.[883] A few studies seek to reconcile these two effects. One paper [884] focuses on dealers' willingness to provide liquidity in certain types of bonds out of inventory. The paper finds that, when transacting in riskier and less liquid bonds, dealers are significantly more likely to offset trades on the same day instead of committing capital overnight. Specifically, the paper documents that dealers offset approximately 75% of trades in the lowest-rated, least-actively-traded bonds, but only 55% of trades in the highest-credit-quality, most-actively-traded bonds. In addition, liquidity provision out of inventory involves risk to the dealer—a risk that is priced in higher transaction costs. As a result, a decline in transaction costs in observed trades may be a reflection of the decline in dealers' willingness to take certain groups of bonds into inventory.

Another study [885] finds that, after the post-crisis banking regulations, including the 2013 rule, customer provision of liquidity has increased and, as a result, the paper posits that bid-ask spread measures will necessarily underestimate the cost of dealer liquidity provision. The paper estimates that, for a subset of large liquidity demanding customer trades in which dealers provide liquidity from their inventory, customers pay between 35% and 65% higher spreads after the crisis than before the crisis.[886] The paper concludes that a large portion of liquidity provision has moved from dealers to large asset managers and that the effect is consistent with the effects of tighter banking regulations.

A recent paper [887] focuses on the effects of the underwriting exemption of the 2013 rule on trading by affected dealers. Specifically, the paper examines changes in the trading and liquidity of newly issued bonds that affected dealers have underwritten relative to bonds that the dealers have not underwritten around the implementation and conformance of the 2013 rule. This empirical design accounts for potentially confounding dealer effects (as dealers trade in bonds that they both underwrite and bonds that they do not) and bond effects (as both underwriters and non-underwriters trade in a given bond), and isolates the effects of the underwriting exemption in the 2013 rule from the effects of other bank regulations during the implementation period of the 2013 rule. The paper estimates that dealer markups have increased by between 42 and 43 basis points for fast roundtrip trades (15 minutes or less) after April 2014, but finds that the effect is transitional and disappears after August of 2015. However, the paper estimates that the adverse effects on dealer markups for slower roundtrip trades of between 15 minutes and 1 day—trades that involve dealers absorbing trades into inventory—are both economically significant and persist past the

[881] *See* Hendrik Bessembinder et al., *Capital Commitment and Illiquidity in Corporate Bonds,* 73 J. Fin. 1615 (2018). For a more detailed discussion of the paper's limitations and caveats, *see* SEC Report 2017, *supra* note 774, at 101–104.

[882] *See* Jens Dick-Nielsen and Marco Rossi, *The Cost of Immediacy for Corporate Bonds,* 32 Rev. Fin. Stud 1 (2019). For a more detailed discussion, *see* SEC Report 2017, *supra* note 774, at 112–13.

[883] *See, e.g.,* SEC Report 2017, *supra* note 774, at 100–105.

[884] *See* Michael Goldstein and Edith Hotchkiss, *Providing Liquidity in an Illiquid Market: Dealer Behavior in U.S. Corporate Bonds,* J. Fin. Econ. (2019) (in press) (accepted manuscript). *See also, e.g.,* SEC Report 2017, *supra* note 774, at 106–107.

[885] *See* Jaewon Choi and Yesol Huh, *Customer Liquidity Provision: Implications for Corporate Bond Transaction Costs,* (Aug. 1, 2019) (working paper), last accessed 8/27/2019). For a more detailed discussion, *see, e.g.,* SEC Report 2017, *supra* note 774, at 117.

[886] In contrast, Bessembinder et al. (2016) focuses on dealer-to-customer principal trades and finds the average transaction cost, particularly for small trades (less than $100,000) and large trades (over $1,000,000), is lowest in the pre-crisis and regulation periods. As the SEC stated elsewhere, the difference between these two results may stem from different proxies for transaction costs and the measurement of principal trading activity.

[887] *See* Meraj Allahrakha et al., *The Effects of the Volcker Rule on Corporate Bond Trading: Evidence from the Underwriting Exemption* (Off. of Fin. Research Working Paper 19–02, 2019) *available at https://www.financialresearch.gov/working-papers/files/OFRwp-19-02_the-effects-of-the-volcker-rule-on-corporate-bond-trading.pdf,* last accessed 8/9/2019.

implementation period (a range of 27–43 bps increase between April 2014 and July 2015, and a range of 18–35 basis point effect after July 2015).[888] To rule out the selection explanation (that dealers post-2013 rule simply pre-arrange more trades so the non-prearranged trades become costlier), the paper tests changes in short-term, non-inventory trades. The paper finds an increase in such trades around the effective date of the 2013 rule, but no differences when conditioning on dealer underwriting activity, and concludes that endogenous selection of time in inventory cannot explain the above results. Moreover, the paper finds that nonbanking dealers enjoy a significant increase in market share after the conformance period, while bank-affiliated dealers lose market share. Finally, the paper concludes that the 2013 rule increased dealer trading risk on short round-trip trades (15 minutes or less), estimating that the standard deviation of covered dealers' markups on corporate bonds has risen by between 0.09 and 0.1.

These results are subject to three primary caveats. First, the paper relies on a relatively narrow measure of risk (the standard deviation of dealer profits at the bond-month level). Unlike other research discussed in this section, the paper does not examine changes in the overall volume of trading activity, measures of downside risk at the individual banking entity level, or commonality of risk exposures among affected and unaffected dealers. Second, some of the paper's tests are affected by small sample sizes, limiting inference related to transitional and permanent effects of the 2013 rule in certain trades (including the 15 minute–1 day subsample and the 60–90 day subsample). Third, the paper recognizes that these results are specific to dealer provision of liquidity in the corporate bond market, and may not extend to trading by affected firms in other asset classes.

Other research helps inform the SEC's understanding of the effects of section 13 of the BHC Act and the 2013 rule on liquidity in times of stress. Specifically, there is growing evidence that liquidity provision in times of stress may be adversely affected by post-crisis reforms in general and the Volcker Rule in particular. Two studies directly test the effects of the Volcker Rule on market making by dealers in times of stress. One of the papers [889] examines liquidity during corporate bond downgrades that result in selling by certain institutions. The paper suggests that dealers affected by the Volcker Rule decreased market making in newly downgraded bonds, and that unaffected dealers have not fully offset this decline. Moreover, the paper rules out the alternative explanation that these changes are attributable to other financial reforms, finding that the same effects are present for dealers affected by the Volcker Rule but not constrained by Basel III and Comprehensive Capital Analysis and Review (CCAR) regulations. The paper isolates the effect in a relatively small sample of bonds experiencing relatively large stress events (under normal aggregate conditions). This methodological design reflects the common tradeoff between a narrower empirical setting that enables causal inference, and a larger sample that is less amenable to causal interpretations.[890]

A related study [891] compares liquidity during times of stress before and after the crisis, and defines times of stress on the basis of extreme increases in market-wide volatility (measured by the VIX index), bond yield drops, and credit rating downgrades from investment grade to speculative grade. While the study does not find that price-based liquidity measures decreased around idiosyncratic shocks, the study does find that the price impact of large trades surrounding market-wide shocks has increased after the post-crisis financial reforms relative to the pre-crisis period.[892]

A recent report by the International Organization of Securities Commissions (IOSCO)'s Committee on Emerging Risks examined changes in bond market liquidity focusing on stressed conditions.[893] The report notes that the most significant effect of post-crisis financial reforms and reduction in dealer risk appetite is the decline in the capacity of dealers to intermediate transactions on a principal basis, combined with a drastic increase in the size of the market. The report concludes that such effects mean the lack of liquidity in times of stress is likely to be more acute than in past episodes of stressed conditions.

One of the important results identified in this literature is the finding that nonbank dealers may step in but may not fully offset the decline in the liquidity provision of bank dealers caused by section 13 of the BHC Act and the 2013 rule.[894] New research suggests that the fundamental mechanism behind this result may be the effect of other post-crisis regulations on the ability of bank dealers to provide funding liquidity to nonbank intermediaries.[895] Specifically, the paper examines the interplay between post-crisis bank regulations, including the Volcker Rule, the supplementary leverage ratio, the liquidity coverage ratio, and the net stable funding ratio, and their effects on the ability of nonbank intermediaries to arbitrage away mispricing. The paper finds that the profitability of classic arbitrage trades (on-the-run/off-the-run, Treasury-interest swap, CDS-bond basis, and single name-index CDS arbitrage trades) is significantly lower under the supplementary leverage ratio, liquidity coverage ratio, and net stable funding ratio components of Basel III compared with Basel II. In addition, using a differences-in-differences estimation, the paper finds that levered hedge funds relying on prime brokers that are identified in the paper as globally systemically important banks experience lower abnormal returns and a decline in assets under management. The paper concludes that the effects of post-crisis regulations affect not only bank intermediation but also the ability of private funds to rely on banks for funding liquidity supporting arbitrage strategies. The paper notes that the supplementary leverage ratio and the net stable funding ratio disincentivize

[888] The paper also finds an increase of between 8% and 14% in dealer markups on trades around the 60-day cutoff for the rebuttable presumption in the 2013 rule. The paper acknowledges that this result could be consistent with dealers conducting profitable proprietary trades and holding positions past the 60-day rebuttable presumption window but is cautious in interpreting the result given the methodological limitations of its empirical design and very small sample size that does not allow conclusive inference.

[889] *See* Jack Bao et al., *The Volcker Rule and Corporate Bond Market Making in Times of Stress,* 130 J. Fin. Econ. 95 (2018).

[890] For a fulsome discussion of this and other issues and limitations, *see* SEC Report 2017, *supra* note 774, at 109–11.

[891] *See* Mike Anderson & René Stulz, *Is Post-Crisis Bond Liquidity Lower?* (Dice Ctr. Working Paper 2017–09, 2017) *last accessed 6/3/2019.*

[892] Consistent with these results, Goldstein and Hotchkiss (2019) finds that on days with large VIX increases, dealers tend to offset trades more quickly even for highly rated bonds that they normally would take into inventory. For a more detailed discussion, *see* SEC Report 2017, *supra* note 774, at 114–15.

[893] *See* OICU–IOSCO, 2019, Liquidity in Corporate Bond Markets Under Stressed Conditions, FR079/2019, May. Available at *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD634.pdf,* last accessed 7/1/2019.

[894] As discussed above, when examining informed trading of advisor banks in options on the stocks of client firms, Lowry et al. (2018) finds that informed trading by hedge funds increases simultaneously with a decrease in informed trading by banks around the enactment of section 13 of the BHC Act. *See* Michelle Lowry et al., *Informed Trading By Advisor Banks: Evidence from Options Holdings,* 32 Rev. Fin. Stud 605 (2018).

[895] *See* Boyarchenko, Eisenbach, Gupta, Shachar, and Van Tassel, 2018, ''Bank Intermediated Arbitrage,'' Federal Reserve Bank of New York Staff Report No. 858, last accessed 6/3/2019.

low margin activities and a reliance on short-term funding, such as repo, and that the liquidity coverage ratio incentivizes holdings of more liquid securities. The paper concludes that Basel III is the regulation with the biggest effect on the profitability of trades exploiting arbitrage opportunities.[896]

Post-crisis regulations may also be having effects on the co-movement [897] in liquidity metrics across markets. A recent paper [898] exploring this issue posits two channels for this increased co-movement in liquidity. First, liquidity supply is capital intensive, and absorbing trades into inventory in one risky asset class may use up the capital capacity of a dealer to provide liquidity in other assets. Basel III and liquidity requirements for banks may aggravate this effect. Second, bank dealers may face uncertainty about their ability to rely on the market making exemption in the 2013 rule, as the distinctions between prohibited proprietary trading and permissible market making may often be unclear. As discussed above, prior studies suggest that the 2013 rule may have reduced the inventory capacity of bank dealers. Empirically, the paper documents that co-movement among measures of illiquidity of stock, bond, and CDS markets has risen significantly after the 2007–2008 financial crisis, particularly during the regulatory implementation period. For example, the regulatory period is characterized by a much larger fraction of firms exhibiting positive pairwise correlations between measures of illiquidity. The paper concludes that the 2013 rule and the tightening of capital and liquidity regulations reduced the inventory capacity of market makers, resulting in higher co-movement in liquidity across various financial markets. Importantly, the paper argues that these results are not consistent with increased electronic trading as that would have resulted in a reduced reliance on market makers and an increased reliance on customers, which should have reduced (instead of increased) co-movement in liquidity across markets.

With respect to liquidity in the dealer-centric, single-name CDS market, the SEC elsewhere found that, while dealer-customer activity and various trading activity metrics have generally remained stable, interdealer trading, trade sizes, number of quotes, and quoted spreads for certain illiquid borrowers have worsened since 2010.[899] In addition, a recent paper [900] seeks to tie financial reforms to trends in liquidity in the single-name CDS markets. Specifically, the paper finds that the sample period (2010 through 2016) saw a decline in interdealer trading, a decrease in net dealer inventories, and a decline in customer transaction volume. In addition, bid-ask spreads in later years are more heavily dependent on individual dealer inventories rather than aggregate inventories of all dealers. Notably, the paper does not estimate the optimal volume of trading activity. Overall, the paper concludes that increased costs of market making have affected liquidity provision in the single-name CDS market.

While these studies are necessarily limited in scope, methodology, and measurement, their results may indicate that section 13 of the BHC Act and the 2013 rule may have reduced dealer provision of liquidity, particularly in times of stress.[901] There is little empirical evidence concerning whether customers will continue to provide liquidity in times of severe market stress, possibly since such empirical settings are scarce in the post-crisis period. One recent paper builds a theoretical model [902] that suggests that constraints on dealer balance sheets may benefit customers and reduce transaction costs as they can induce dealers to invest in technology designed to match customers to each other. However, this model does not explicitly examine dealer behavior in times of stress. In addition, the results rely on strong modeling assumptions. The model assumes that only bank dealers are able to develop technology to match customers and assumes away the role of an inter-dealer market or competition among dealers in the interdealer market. If these assumptions are violated, it is unclear whether the results will continue to hold. For example, if nonbank dealers (as well as bank dealers) can develop customer matching technology, constraining dealer balance sheets may not be necessary for the development of technology matching customers to other customers or the disintermediation of trading, with its resulting welfare improvements. Similarly, in the presence of an interdealer market, constraining dealer balance sheets may benefit customers by facilitating customer-to-customer trading but may also reduce the ability of dealers to demand liquidity from other dealers.

Moreover, as discussed above, existing research suggests that non-dealer institutions may be constrained in their ability to secure funding from prime brokers that are affected by post-crisis regulations, limiting the ability of non-dealers to arbitrage away mispricings. It is even less clear whether customers would be willing and able to secure funding liquidity and stand on the buy side of customer sells during severe market stress across asset markets.

Finally, the agencies also received comment that end-users are increasingly finding that their bank counterparties have reduced short-term lending and repo activity, while other end-users are experiencing higher discounts to posted collateral as a result of the 2013 rule.[903] The SEC is informed by research on the effects of the constraints dealers face as a result of post-crisis regulations and liquidity provision.[904] One particular study on this issue [905] finds that dealer balance sheet constraints have broad market-wide effects on bond liquidity beyond the liquidity of bonds with a particular credit rating, sector, or issue size. The paper finds that, prior to the crisis, bonds were more liquid when they were traded by more levered dealers, dealers with higher return on assets and lower vulnerability

[896] These findings are also consistent with another paper that finds an exogenous increase in the leverage ratio constraint in the UK to have reduced repo market liquidity—an effect especially pronounced in transactions between dealers and small customers. *See* Antonis Kotidis and Neeltje Horen, *Repo Market Functioning: The Role of Capital Regulation* (2018) (working paper) last accessed June 3, 2019.

[897] Co-movement in two variables generally refers to a positive correlation of changes in the two variables over time. For example, co-movement in returns refers to a pattern of positive correlation in returns among different securities or asset classes. Similarly, co-movement in liquidity metrics suggests a positive correlation of changes in liquidity metrics. *See, e.g.,* Nicholas Barberis et al., *Co-movement,* 75 J. Fin. Econ. 283 (2005).

[898] *See* Xinjie Wang et al., *Do Post-Crisis Regulations Affect Market Liquidity? Evidence from the Co-Movement of Stock, Bond, and CDS Illiquidity* (2018) (working paper) last accessed 6/3/2019.

[899] *See* SEC Report 2017, *supra* note 774.

[900] *See* Mark Paddrik and Stathis Tompaidis, *Market Making Costs and Liquidity: Evidence from CDS Markets* (Off. of Fin. Research Working Paper 19–01, 2019) *available at https://www.financialresearch.gov/working-papers/files/OFRwp-19-01_Market-Making-Costs-and-Liquidity-Evidence-from-CDS-Markets.pdf,* last accessed 7/5/2019.

[901] *See, e.g., supra* notes 881, 887, 889, and 891.

[902] *See* Gideon Saar et al., *From Market Making to Matchmaking: Does Bank Regulation Harm Market Liquidity?* (May 22, 2019) (working paper) last accessed June 3, 2019.

[903] *See* Coalition for Derivatives End Users.

[904] For a more general model of the links between repo market frictions and liquidity in underlying cash markets *see, e.g.,* Yesol Huh and Sebastian Infante, *Bond Market Intermediation and the Role of Repo* (Oct. 22, 2018) (working paper) last accessed 6/3/2019.

[905] *See* Tobias Adrian et al., *Dealer Balance Sheets and Bond Liquidity Provision,* 89 J. Monetary Econ. 92 (2017).

See also SEC Report 2017, *supra* note 774, at 115–16.

(measured by conditional value-at-risk),[906] dealers with lower risk-weighted assets, and dealers with relatively low reliance on repo. However, during the rule implementation period (post-2014) these results have reversed, and bonds are more liquid when they are traded by less-levered dealers, dealers with lower return on assets, dealers with higher risk-weighted assets, and dealers with more reliance on repo funding. Finally, unlike the pre-crisis period, during the rule implementation period (post-2014), dealers with more reliance on repo funding, with higher trading revenues, with larger maturity mismatches, with higher measures of vulnerability, and with fewer assets held as loans are less likely to accommodate customer order flow and are more likely to access the interdealer market instead. Though these results do not speak to dealer behavior in times of stress, they are based on a substantially larger sample compared with the discussed above work showing liquidity declines in times of stress. Overall, while the paper does not delineate the effects of the Volcker Rule from other post-crisis regulations (such as the supplemental leverage ratio), the paper's findings indicate that tightening of dealer balance sheet constraints due to the package of post-crisis financial regulations may adversely affect the ability of affected dealers to intermediate customer trading in bond markets.

The SEC also recognizes that the effects of the 2013 rule on the ability and willingness of banks to engage in repo activity may be compounded by other post-crisis reforms. For example, one study [907] focuses on the effects of the liquidity coverage ratio, exploiting cross-country differences in the implementation of the rule. The paper finds that, as a result of the liquidity coverage ratio, U.S. dealers reduced their reliance on repo in funding high-quality liquid assets by more, and increased the maturity of lower-quality-collateral repos by more, than did foreign dealers.

Importantly, reduced ability and willingness to engage in repo activity are likely to have downstream effects on customers and market quality. For example, a paper [908] recently showed that dealers' ability to rely on repos to finance bond inventory has an effect on bid-ask spreads and bond transaction costs; that dealers with less access to funding liquidity are less likely to provide liquidity on a principal basis and are more likely to trade on an agency basis instead; and that funding liquidity has causal effects on bond market liquidity.

As discussed above, corporate bond dealers, particularly bank-affiliated dealers, may have, on aggregate, reduced their capital commitment post-crisis—a result that is consistent with a reduction in liquidity provision in corporate bonds because of the 2013 rule. In addition, the 2013 rule may have resulted in many corporate bond dealers shifting from trading in a principal capacity to agency trading. Moreover, corporate bond dealers may decrease liquidity provision during certain times of stress in general (*e.g.,* during a financial crisis) [909] and after the 2013 rule in particular, as discussed above. Nonbank dealers and non-dealer intermediaries may not have fully offset the shortfall in liquidity provision, partly because of their reliance on funding from financial institutions affected by post-crisis financial reforms.

The SEC recognizes that the effects of the 2013 rule on the activities of banking entities and conflicts of interest may flow through to SEC-registered dealers and investment advisers affiliated with banks and bank holding companies directly (if banks and holding companies transact through their dealer affiliates) and indirectly (*e.g.,* through effects on capital requirements, profitability, compliance systems, and policies and procedures), and may have an effect on securities markets. As discussed in the proposal,[910] the presence and magnitude of spillover effects across different types of financial institutions vary over time and may be more significant in times of stress.[911]

iv. Compliance Burdens, Profitability, and Competitive Effects

In the proposal, the SEC recognized that the scope and breadth of the compliance obligations impose costs on banking entities, which may be particularly important for smaller entities.[912] The SEC noted commenters' estimates that banking entities may have added as many as 2,500 pages of policies, procedures, mandates, and controls per institution for the purposes of compliance with the 2013 rule, which need to be monitored and updated on an ongoing basis, and that some banking entities may spend, on average, more than 10,000 hours on training each year. In terms of ongoing costs, in the proposal the SEC noted a market participant's estimate that some banking entities may have 15 regularly meeting committees and forums, with as many as 50 participants per institution dedicated to compliance with the 2013 rule.

In connection with the proposal, the agencies have received a number of comments on the compliance burdens of the 2013 rule. Some commenters presented trends in bank profitability, trading revenue, and loan growth, arguing that the proposed amendments are unnecessary.[913] Others indicated that the Volcker Rule may reduce bank profits due to the elimination of proprietary trading but that lost profits are not costs but intended regulatory effects of section 13 of the BHC Act.[914]

[906] *See* Tobias Adrian and Markus Brunnermeier, *CoVar,* 106 Am. Econ. Rev. 1705 (2016).

[907] *See* Marco Macchiavelli and Luke Pettit, *Liquidity Regulation and Financial Intermediaries* (Jul. 29, 2019) (working paper) last accessed 8/29/2019.

[908] *See* Marco Macchiavelli and Xing Zhou, *Funding Liquidity and Market Liquidity: The Broker-Dealer Perspective* (Jul. 17, 2019) (working paper) last accessed 8/29/2019.

[909] Dealers provide less liquidity to clients and peripheral dealers during stress times; during the peak of the crisis, core dealers charged higher spreads to peripheral dealers and clients but lower spreads to dealers with whom they had strong ties. *See* Marco Di Maggio et al., *The Value of Trading Relationships in Turbulent Times,* 124 J. Fin. Econ. 266 (2017). *See also* Jaewon Choi and Or Shachar, *Did Liquidity Providers Become Liquidity Seekers?* (Oct., 2013), New York Fed Staff Report No. 650.

[910] *See* 83 FR at 33534.

[911] *See, e.g.,* Monica Billio et al., *Econometric Measures of Connectedness and Systemic Risk in the Finance and Insurance Sectors,* 104 J. Fin. Econ. 535 (2012). *See also* Zeno Adams et al., *Spillover Effects Among Financial Institutions: A State-Dependent Sensitivity Value at Risk Approach (SDSVar),* 49 J. Fin. & Quantitative Analysis 575 (2014). *See also* Adrian and Brunnermeier (2016) *supra* note 906.

[912] *See, e.g.,* 83 FR at 33550.

[913] *See, e.g.,* Volcker Alliance and AFR.

[914] *See, e.g.,* Occupy the SEC.

In response to those comments, the SEC continues to note that the scope of this economic analysis is limited to SEC registrants, and securities markets and their participants. Importantly, trends in profitability are not informative of the direct causal effect on profitability or compliance burdens of section 13 of the BHC Act or of the 2013 rule, since there is no data about the amount of revenue or compliance burdens that would have occurred in the absence of the 2013 rule. Moreover, the agencies have received a number of comments pointing to large and significant burdens of section 13 of the BHC Act and various components of the agencies' 2013 rule. For example, one commenter estimated that proprietary trading requirements related to RENTD involved annual costs of as much as about $513 million; that the metrics-related policies and procedures requirements involved initial burdens of approximately $41.5 million; that total compliance expenditures of affected entities (including with respect to covered funds) totaled between $402 million and $541 million; and that covered funds requirements involved a cost of between $152 million and $690 million.[915] Another commenter estimated that, for at least one banking entity, sorting counterparties into customers and non-customers for the purposes of calculating RENTD requires dozens of employees spending thousands of hours in initial and ongoing burdens.[916] Another commenter stated that simplifying covered funds requirements would eliminate thousands of unnecessary hours in compliance burdens related to activities that do not raise the concerns intended to be addressed by section 13 of the BHC Act.[917] One trade organization indicated that duplicative examinations drastically increase burdens on registrants, estimating that in 2016 members of the organization spent in aggregate over 50,000 hours responding to inquiries and examinations related to section 13 of the BHC Act.[918]

Moreover, the SEC notes that risk-averse market participants are compensated for bearing greater systematic [919] risks with higher expected returns.[920] If capital markets have a high degree of efficiency and arbitrage opportunities are generally scarce, greater profitability may simply be indicative of greater risks taken on by banking entities. Setting aside the challenges of causal inference discussed above, trends in bank profitability may reflect not only compliance burdens of the 2013 rule, but also the effects of the 2013 rule on banking entity risk exposures from permissible activities. That is, banking entities may have become more willing to take risk through engaging in activities permitted by the 2013 rule. For more discussion of the existing evidence on the effects of the 2013 rule on the activities of banking entities, see the preceding sections of the economic baseline.

The agencies also received a number of comments concerning the need to tailor regulations to banking entities on the basis of risk profile in order to balance the intended regulatory goals with compliance burdens and competitive effects. Specifically, a number of commenters supported tailoring the 2013 rule to more effectively accomplish the underlying goals of section 13 of the BHC Act, reduce unnecessary compliance burdens, particularly on smaller and mid-sized banking entities and entities with small trading books, and more effectively allocate supervisory resources to prudential goals.[921]

The SEC continues to believe that the compliance regime under the 2013 rule and related burdens reduce the profitability of permissible activities by bank-affiliated dealers and investment advisers and may be passed along to customers or clients in the form of reduced provision of services or higher service costs.[922] Moreover, the SEC continues to believe that the extensive compliance program under the 2013 rule detracts resources of some banking entities and their compliance departments and supervisors from other compliance matters, risk management, and supervision. Finally, the SEC continues to believe that prescriptive compliance requirements may not optimally reflect the organizational structures, governance mechanisms, or risk management practices of complex, innovative, and global banking entities.

In the sections that follow the SEC discusses rule provisions of the 2013 rule, how each amendment in the final rule changes the economic effects of the regulatory requirements, and the anticipated costs and benefits of the amendments.

c. Affected Participants

The SEC-regulated entities directly affected by the final rule include broker-dealers, security-based swap dealers, and investment advisers.

i. Broker-Dealers [923]

Under the 2013 rule, some of the largest SEC-regulated broker-dealers are banking entities because they are affiliated with banks or bank holding companies. Table 1 reports the number, total assets, and holdings of broker-dealers by the broker-dealer's bank affiliation.

[915] *See* Data Boiler, citing its own analysis as well as SIA Partners Briefing Note, July 2015, ''Volcker Implementation,'' available at *http://en.finance.sia-partners.com/sites/default/files/post/sia_partners_-_briefing_note_volcker_coveredfunds_blog_version.pdf,* last accessed 6/4/2019.

[916] *See* CCMC.

[917] *See* SFIG.

[918] *See* SIFMA.

[919] The term ''systematic risk'' generally refers to the variability of returns due to macroeconomic factors that affect all risky assets and, thus, cannot be eliminated by diversification. *See* Frank Reilly & Keith Brown, Investment Analysis & Portfolio Management, 1025 (9th ed. 2009). *See also* Bodie, *supra* note 840, at G–12.

[920] *See supra* note 840.

[921] *See, e.g.,* IIB; CCMC; CREFC; CCMR; Covington; Capital One et al. and Credit Suisse.

[922] *See* 83 FR at 33550.

[923] These estimates differ from the estimates in the proposal and in the EGRRCPA Conforming Amendments Adopting Release, as these estimates rely on more recent data and information about both U.S. and global trading assets and liabilities of bank holding companies. This analysis is based on data from Reporting Form FR Y–9C for domestic holding companies on a consolidated basis and Report of Condition and Income for banks regulated by the Board, FDIC, and OCC for the most recent available four-quarter average, as well as data from S&P Market Intelligence LLC on the estimated amount of global trading activity of U.S. and non-U.S. bank holding companies. Broker-dealer bank affiliations were obtained from the Federal Financial Institutions Examination Council's (FFIEC) National Information Center (NIC). Broker-dealer assets and holdings were obtained from FOCUS Report data for Q4 2018.

While the 199 bank-affiliated broker-dealers subject to the 2013 rule (affected broker-dealers) are greatly outnumbered by the 3,595 broker-dealers that are either bank broker-dealers exempt under section 203 of EGRRCPA or nonbank broker-dealers, the affected broker-dealers dominate other broker-dealers in terms of total assets (72.7% of total broker-dealer assets) and aggregate holdings (66.5% of total broker-dealer holdings).

TABLE 1—BROKER-DEALER COUNT, ASSETS, AND HOLDINGS BY AFFILIATION

Broker-dealer bank affiliation	Number	Total assets, $mln [924]	Holdings, $mln [925]	Holdings (altern.), $mln [926]
Bank broker-dealers affected by the final rule [927]	199	3,142,780	761,532	567,387
All other broker-dealers [928]	3,595	1,179,805	382,451	225,675
Total	3,794	4,322,586	1,143,983	793,062

Some of the amendments to the 2013 rule that the agencies are adopting differentiate banking entities on the basis of their consolidated trading assets and liabilities.[929] Table 2 reports affected broker-dealer counts, assets, and holdings by consolidated trading assets and liabilities of the (top-level) parent firm. The SEC estimates that 163 broker-dealer affiliates of firms with less than $20 billion in consolidated trading assets and liabilities account for 20.4% of bank-affiliated broker-dealer assets and 17.8% of holdings (or 7% using the alternative measure of holdings).[930]

TABLE 2—BROKER-DEALER COUNTS, ASSETS, AND HOLDINGS BY CONSOLIDATED TRADING ASSETS AND LIABILITIES OF THE BANKING ENTITY [931]

Consolidated trading assets and liabilities [932]	Number	Total assets, $mln	Percent	Holdings, $mln	Percent	Holdings (altern.), $mln	Percent
≥50bln	28	2,152,225	68	555,787	73	510,325	90
20bln–50bln	8	349,716	11	70,054	9	17,611	3
10bln–20bln	9	198,895	6	49,797	7	13,301	2
5bln–10bln	24	261,622	8	55,316	7	14,295	3
1bln–5bln	33	66,583	2	18,319	2	4,998	1
≤1bln	97	113,740	4	12,259	2	6,857	1
Total	199	3,142,780	100	761,532	100	567,387	100

ii. Security-Based Swap Dealers

The final rule may also affect bank-affiliated SBSDs. As compliance with SBSD registration requirements is not yet required, there are currently no registered SBSDs. However, the SEC has previously estimated that as many as 50 entities may potentially register as security-based swap dealers and that as many as 16 of these entities may already be SEC-registered broker-dealers.[933] Similarly, the SEC previously estimated that between 0 and 5 entities may register as Major Security-Based Swap Participants (MSBSPs).[934] On the basis of the analysis of TIW transaction and positions data on single-name credit-default swaps, the SEC believes that all entities that may register with the SEC as SBSDs are bank-affiliated firms, including those that are SEC-registered broker-dealers. Therefore, the SEC estimates that, in addition to the bank-affiliated SBSDs that are already registered as broker-dealers and included in the discussion above, as many as 34 other bank-affiliated SBSDs may be affected by these amendments. Similarly, on the basis of the analysis of TIW data, the SEC estimates that none of the entities that may register with the SEC as MSBSPs are affected by the final rule.

Importantly, compliance with capital and other substantive requirements for SBSDs under Title VII of the Dodd-Frank Act is not yet required.[935] The SEC recognizes that firms may choose to move security-based swap trading activity into (or out of) an affiliated bank or an affiliated broker-dealer instead of registering as a standalone SBSD, if bank or broker-dealer capital and other regulatory requirements are less (or more) costly than those that may be imposed on SBSDs under Title VII. As a result, the above figures may

[924] Broker-dealer total assets are based on FOCUS report data for "Total Assets."

[925] Broker-dealer holdings are based on FOCUS report data for securities and spot commodities owned at market value, including bankers' acceptances, certificates of deposit and commercial paper, state and municipal government obligations, corporate obligations, stocks and warrants, options, arbitrage, other securities, U.S. and Canadian government obligations, and spot commodities.

[926] This alternative measure excludes U.S. and Canadian government obligations and spot commodities.

[927] This category includes all bank-affiliated broker-dealers except those exempted by section 203 of EGRRCPA.

[928] This category includes both bank affiliated broker-dealers subject to section 203 of EGRRCPA and broker-dealers that are not affiliated with banks or holding companies.

[929] *See, e.g.,* 2013 rule § ■ ■.20(d)(1).

[930] *See supra* note 926.

[931] This analysis excludes SEC-registered broker-dealers subject to section 203 of EGRRCPA.

[932] Consolidated trading assets and liabilities are estimated using information reported in form FR Y–9C data and from S&P Market Intelligence LLC on the estimated amount of global trading activity provided for U.S. and non-U.S. firms. These estimates exclude from the definition of consolidated trading assets and liabilities government, agency, and GSE securities. U.S. trading assets and liabilities are calculated on the basis of the most recent four-quarter average, except for foreign firms without an intermediate holding company, for which the amount of trading activity for the nonbank and edge subsidiaries does not exclude securities of government-sponsored enterprises. For top-tier bank holding companies, top-tier independent depositary institutions, and foreign parents with U.S. activity, Ginnie Mae securities are included in the calculation of trading assets and liabilities because of data limitations. (It is not possible to exclude Ginnie Mae securities without also excluding Fannie Mae and Freddie Mac securities.)

[933] *See* Capital, Margin, Segregation Adopting Release, 84 FR at 43960.

[934] *Id.*

[935] *Id.*

overestimate or underestimate the number of SBSDs that are not broker-dealers and that may become SEC-registered entities affected by the final rule. Quantitative cost estimates are provided separately for affected broker-dealers and potential SBSDs.

iii. Private Funds and Private Fund Advisers [936]

This section focuses on RIAs advising private funds. Using Form ADV data, Table 3 reports the number of RIAs advising private funds by fund types, as those types are defined in Form ADV. Table 4 reports the number and gross assets of private funds advised by RIAs and separately reports these statistics for bank-affiliated RIAs. As can be seen from Table 3, the two largest categories of private funds advised by RIAs are hedge funds and private equity funds.

Bank-affiliated RIAs advise a total of 4,316 private funds with approximately $2 trillion in gross assets. Per Form ADV data, bank-affiliated RIAs' gross private fund assets under management are concentrated in hedge funds and private equity funds. On the basis of this data, bank-affiliated RIAs advise 929 hedge funds with approximately $668 billion in gross assets and 1,420 private equity funds with approximately $395 billion in assets. While bank-affiliated RIAs are subject to all of section 13's restrictions, because RIAs do not typically engage in proprietary trading, the SEC continues to believe that they will not be affected by the final rule as it relates to proprietary trading.

TABLE 3—SEC-REGISTERED INVESTMENT ADVISERS ADVISING PRIVATE FUNDS, BY FUND TYPE [937]

Fund type	All RIA	Bank-affiliated RIA
Hedge Funds	2,656	154
Private Equity Funds	1,644	98
Real Estate Funds	526	52
Securitized Asset Funds	220	45
Liquidity Funds	46	16
Venture Capital Funds	193	8
Other Private Funds	1,066	146
Total Private Fund Advisers	4,756	296

TABLE 4—THE NUMBER AND GROSS ASSETS OF PRIVATE FUNDS ADVISED BY SEC-REGISTERED INVESTMENT ADVISERS [938]

Fund type	Number of private funds		Gross assets, $bln	
	All RIA	Bank-affiliated RIA	All RIA	Bank-affiliated RIA
Hedge Funds	10,431	929	7,160	668
Private Equity Funds	14,775	1,420	3,446	395
Real Estate Funds	3,472	320	646	100
Securitized Asset Funds	1,814	358	661	129
Liquidity Funds	83	30	297	195
Venture Capital Funds	1,201	43	136	3
Other Private Funds	4,460	1,217	1,396	474
Total Private Funds	36,230	4,316	13,741	1,964

In addition, for an additional period of 2 years until July 21, 2021, the banking agencies will not treat qualifying foreign excluded funds that meet the conditions included in the policy statement discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the policy statement.[939]

iv. Registered Investment Companies

The potential that a registered investment company (RIC) or a business development company (BDC) would be treated as a banking entity where the fund's sponsor is a banking entity and holds 25% or more of the RIC or BDC's voting securities after a seeding period also forms part of the baseline. On the basis of Commission filings and public data, the SEC estimates that, as of year-end 2018, there were approximately

[936] These estimates are calculated from Form ADV data as of March 31, 2019. An investment adviser is defined as a ''private fund adviser'' if it indicates that it is an adviser to any private fund on Form ADV Item 7.B. An investment adviser is defined as a ''bank-affiliated RIA'' if it indicates on Form ADV Item 6.A.(7) that it is actively engaged in business as a bank, or it indicates on Form ADV Item 7.A.(8) that it has a ''related person'' that is a banking or thrift institution. For purposes of Form ADV, a ''related person'' is any advisory affiliate and any person that is under common control with the adviser. The definition of ''control'' for purposes of Form ADV, which is used in identifying related persons on the form, differs from the definition of ''control'' under the BHC Act. In addition, this analysis does not exclude SEC-registered investment advisers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets. Thus, these figures may overestimate or underestimate the number of bank-affiliated RIAs.

[937] This table includes only the advisers that list private funds on Section 7.B.(1) of Form ADV. The number of advisers in the ''Any Private Fund'' row is not the sum of the rows that follow, since an adviser may advise multiple types of private funds. Each listed private fund type (*e.g.,* real estate fund, liquidity fund) is defined in Form ADV, and those definitions are the same for purposes of the SEC's Form PF.

[938] Gross assets include uncalled capital commitments on Form ADV.

[939] *See* ''Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act,'' July 19, 2019, available at *https://www.occ.gov/news-issuances/news-releases/2019/nr-ia-2019-79a.pdf,* last accessed July 19, 2019.

15,700 RICs[940] and 104 BDCs. Although RICs and BDCs are generally not banking entities themselves subject to the 2013 rule, they may be indirectly affected by the 2013 rule and the final rule, for example, if their sponsors or advisers are banking entities. For instance, bank-affiliated RIAs or their affiliates may reduce their level of investment in the funds they advise, or potentially close those funds, to avoid those funds becoming banking entities themselves.

v. Entities Reporting Metrics to the SEC[941]

The regulatory reporting requirements of the 2013 rule with respect to bank-affiliated broker-dealers, SBSDs, and RIAs are described in section V.F.2.a above. As discussed below, the final rule increases the threshold for entities subject to metrics reporting from the $10 billion under the 2013 rule to $20 billion in trading assets and liabilities. Moreover, the final amendments that link the trading desk definition to the market risk capital rule have an effect on the volume of reporting to the SEC and corresponding burdens.

The agencies have received a number of comments opposing the proposed amendments to metrics reporting and challenging the agencies' assessment of the proposed amendments.[942] For example, one commenter indicated that the SEC's assessment of the overall streamlining effects of the amendments to metrics reporting and recordkeeping will not be supported by a full-fledged cost-benefit analysis.[943] Another commenter stated that the proposal presented no analysis showing that the benefits of eliminating some metrics outweigh the costs of imposing new metrics.[944] A number of commenters indicated that the agencies should not adopt any of the proposed amendments to metrics reporting as they would result in a significant net increase in metrics data.[945] One commenter estimated that the proposed requirements would require its member institutions to report hundreds of thousands of additional data points each month.[946] One commenter indicated that the extended reporting timeframe for metrics submission is insufficient and frequent resubmissions are likely to persist.[947] In response to these comments and to enable a quantification of the economic effects of the metrics amendments on the volume and timeliness of metrics reporting, the SEC is updating the economic baseline with summary information about the current volume and resubmission statistics by different groups of Appendix A filers.

TABLE 5—VOLUME OF METRICS RECORDS SUBMITTED TO THE SEC, BY TRADING ASSETS AND LIABILITIES[948]

Trading assets & liabilities	Number of reporters	Records submitted
>50bln	8	40,771,825
20bln–50bln	4	7,357,794
<20bln	6	10,440,677
Total	18	58,570,296

TABLE 6—TRADING DESKS REPORTING METRICS TO THE SEC, BY TRADING ASSETS AND LIABILITIES

Trading assets & liabilities	Average number of desks	Average number of records per submission	Average number of records per desk
>50bln	56	450,921	7,588
20bln–50bln	43	195,010	5,172
<20bln	38	216,433	7,093

TABLE 7—TIME DELAYS AND RESUBMISSIONS OF METRICS RECORDS SUBMITTED TO THE SEC

Trading assets & liabilities	Total number of submitted records	Percent of records not resubmitted	Percent of records resubmitted once	Percent of records resubmitted twice
Panel A. Resubmissions of Initial Records				
>50bln	40,785,033	34	56	10
20bln–50bln	6,908,332	61	39	0
<20bln	10,441,265	96	4	0

[940] This estimate includes open-end companies, exchange-traded funds, closed-end funds, and non-insurance unit investment trusts and does not include fund of funds. The inclusion of fund of funds increases this estimate to approximately 17,200.

[941] The estimates in this section are based on Appendix A information provided by reporters to the SEC under the 2013 rule at the holding company level for April 2018 through March 2019, based on the most complete filing for each reporting period. Appendix A records for a particular trading desk are reported to the SEC if a trading desk books activity into the SEC registrant.

[942] *See, e.g.,* ABA; Credit Suisse; CCMR; FSF, Public Citizen and SIFMA.

[943] *See* SIFMA Annex C.

[944] *See* CCMR.

[945] *See, e.g.,* CCMC and FSF.

[946] *See* FSF.

[947] *See* SIFMA Annex C.

[948] For the purposes of this analysis, each record is one line of the matrix reported to the SEC, with the value filled out by the reporting entity, on a monthly basis, for all its related trading desks. The total number of records also includes the header, body, and footer. Each submission is the full data matrix reported by the reporting entity to the SEC for any specific reporting month.

Trading assets & liabilities	Total records submitted late (initial submission)	Percent of late initial submissions	Average delay in initial submissions (days, simple average)	Average delay in initial submissions (days, weighted by record count)
Panel B. Delayed Submission of Initial Records				
>50bln	4,771,713	12	2	2
20bln–50bln	4,020,778	58	32	32
<20bln	10,437,647	99.97	46	42

The SEC notes two important caveats relevant for the interpretation of these statistics. First, direct attribution of specific trading activity by a trading desk to an SEC registrant or group of registrants is not feasible, since the trading desk may book transactions into multiple legal entities, including both those registered with the SEC as well as those that are not registered. As a result, the scope of activity reported in this section is likely to overestimate the records and reporting by legal entities registered with the SEC. Second, the SEC does not receive reporting from trading desks that do not transact on behalf of SEC-registered entities. Therefore, these estimates may significantly underestimate the overall volume of metrics reporting by all banking entities (including those that are not registered with the SEC) related to the 2013 rule.

3. Economic Effects

a. Treatment of Entities Based on the Size of Trading Assets and Liabilities

As proposed, the agencies are adopting a categorization of banking entities into three groups on the basis of the size of their trading activity. Under the final rule, banking entities with significant trading assets and liabilities (Group A entities) are required to comply with a streamlined but comprehensive version of the 2013 rule's compliance program requirements, as discussed below. Banking entities with moderate trading assets and liabilities (Group B entities) are subject to reduced requirements and an even more tailored approach in light of their smaller trading activities. The burdens are further reduced for banking entities with limited trading assets and liabilities (Group C entities), for which the amendments establish a presumption of compliance, which can be rebutted by the agencies. The sections that follow discuss the economic effects of each of the amendments on these groups of entities.

i. Costs and Benefits

First, banking entities with significant trading assets and liabilities are defined as those that have, together with affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § ▮▮.6(a)(1) and (2) of subpart B) the average gross sum of which, over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $20 billion.[949] This $20 billion threshold is higher than the threshold that the agencies proposed in the proposal. Accordingly, more banking entities may qualify as Group B entities rather than Group A entities (as compared to those that would have qualified under the proposal's lower threshold), which will reduce compliance burdens for more banking entities relative to the proposal.[950] The agencies received comments that a higher than the proposed $10 billion trading assets and liabilities threshold would provide Group B banking entities that are near or approaching $10 billion threshold with flexibility to have moderate growth over time and to manage their business without triggering the more stringent compliance requirements imposed on Group A banking entities.[951] In addition, some commenters stated that potential fluctuations resulting from customer-driven trades, quarter-end activity, and market and foreign exchange volatility may cause banking entities that are near or approaching the $10 billion threshold to exceed this threshold.[952] The SEC recognizes that fluctuations in customer demand or market events may cause these banking entities to exceed the $10 billion threshold temporarily or permanently, which could trigger a more enhanced compliance regime and expose these banking entities to higher compliance costs.[953] Thus, a $20 billion threshold accounts for such fluctuations and provides banking entities that are near or approaching $10 billion in trading assets and liabilities with more certainty regarding their compliance burdens.

Some commenters stated that changing the threshold from $10 to $20 billion would have minimal effect on the number of banking entities that would remain categorized as having significant trading assets and liabilities.[954] The SEC estimates that there are 66 broker-dealers with approximately 16% of all broker-dealer holdings (or 6% based on the alternative measure) that would qualify as Group B entities with the adopted $20 billion threshold—compared to 57 broker-dealers with between 9% and 4% of all broker-dealer holdings that would have qualified under the proposed threshold value. Thus, relative to the proposal, 15 additional broker-dealers will experience the cost reduction because of reduced compliance burdens.

Second, as in the proposal, the agencies are defining a banking entity with limited trading assets and liabilities as a banking entity that has, together with its affiliates and subsidiaries on a consolidated basis, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § ▮▮.6(a)(1) and (2) of subpart B) the average gross sum of which, over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is

[949] With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, this threshold for having significant trading assets and liabilities applies according to the trading assets and liabilities of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

[950] The final rule defines banking entities with moderate trading assets and liabilities as those that are neither banking entities with significant trading assets and liabilities nor banking entities with limited trading assets and liabilities.

[951] *See, e.g.,* Capital One et al.; ABA; BPI; and Custody Banks.

[952] *See, e.g.,* Custody Banks and BPI.

[953] *See supra* note 123.

[954] *See, e.g.,* ABA; Custody Banks; New England Council; Capital One et al.; SIFMA; State Street and BPI.

less than $1 billion. However, in the proposal, the agencies proposed this threshold to be calculated on the worldwide consolidated basis for both foreign and domestic registrants. Unlike in the proposal, with respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, this threshold will be applied on the basis of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

The SEC continues to recognize that the 2013 rule may have resulted in significant compliance burdens for banking entities that do not have significant U.S. operations, even though such entities may not pose substantial risks to the U.S. financial system because of their limited presence in the U.S. The SEC estimates that the adopted definition of limited trading assets and liabilities will allow 97 broker-dealers to reduce compliance costs related to the 2013 rule as a result of the final rule's presumption of compliance. In contrast, if the final rule adopted the proposed calculation of limited trading assets and liabilities, some foreign broker-dealers would not qualify as those affiliated with entities with limited trading assets and liabilities, even though the entities these broker-dealers are affiliated with may have very limited activity in the U.S.

Third, in the final rule the calculation of thresholds for limited and significant trading assets and liabilities will exclude—in addition to the proposed exclusion of trading assets and liabilities involving obligations of, or guaranteed by, the United States, or any agency of the United States—trading assets and liabilities involving obligations, participations, or other instruments of, or issued or guaranteed by, government-sponsored enterprises listed in § ▮▮.6(a)(2). Some commenters stated that the calculation of trading assets and liabilities should exclude financial instruments that are not regulated under the 2013 rule.[955] The SEC recognizes that inclusion of trading assets and liabilities involving obligations of, participations by, or other instruments of, or issued or guaranteed by, government-sponsored enterprises in the calculation of trading assets and liabilities may inadvertently scope in entities whose trading assets and liabilities primarily consist of financial instruments that are excluded from the prohibition on proprietary trading under the 2013 rule.[956] Accordingly, the final rule will better align the application of the tiered compliance regime with trading activities that are subject to the proprietary trading prohibitions. The SEC estimates that the exclusion of the aforementioned trading assets and liabilities from the calculation of the $1 billion and $20 billion thresholds will not change the assignment of banking entities into the tiered compliance groups.

The SEC continues to believe that the primary effect of these amendments for SEC registrants is the reduced compliance burdens, as discussed in more detail in later sections. To the extent that the compliance costs are currently passed along to customers and counterparties, some of the cost reductions for these entities associated with the final rule may flow through to counterparties and clients in the form of reduced transaction costs or a greater willingness to engage in activity, including intermediation that facilitates risk-sharing.

The SEC notes that, from above, Group B and Group C broker-dealers currently account for approximately 7% to 18% of total bank broker-dealer holdings and that, to the extent that holdings reflect risk exposure resulting from trading activity, current trading activity by Group B and Group C entities may represent lower risks than the risks posed by Group A entities' trading activities addressed in the 2013 rule. In addition, the SEC continues to recognize that some Group B and Group C entities that currently exhibit low levels of trading activity because of the costs of compliance may respond to the final rule by increasing their trading assets and liabilities while still remaining under the $20 billion or $1 billion threshold, as applicable. Increases in aggregate risk exposure by Group B and Group C entities may be magnified if trading activity becomes more highly correlated among such entities, or dampened if trading activity becomes less correlated among such entities. Since it is difficult to estimate the number of Group B and Group C entities that may increase the riskiness of their activities and the degree to which their trading activity would be correlated, the implications of this effect for aggregate risk and capital market activity are unclear.

The shifts in risk exposure may have two competing effects. On the one hand, if Group B and Group C entities are able to bear risk at a lower cost than their customers, increased risk exposures could promote secondary market trading activity and capital formation in primary markets and increase access to capital for issuers, benefitting issuers and investors. On the other hand, Group B and Group C firms may be incentivized to increase their risk exposures, resulting in more aggregate risk in the banking sector, greater market fragility, and exacerbated conflicts of interest between banking entities and their customers. This may ultimately adversely affect issuers and investors. However, the SEC continues to recognize that the amendments are focused on tailoring the compliance regime based on the amount of trading activity engaged in by each banking entity, and all banking entities would still be subject to the statutory prohibitions related to such activities. Thus, the potential risk of increased market fragility and the severity of conflicts of interest effects is mitigated.

In response to the final rule, it is possible that trading activity that was once consolidated within a small number of unaffiliated banking entities may become fragmented among a larger number of unaffiliated banking entities that each manage down their trading books under the $20 billion and $1 billion trading assets and liabilities thresholds to enjoy reduced hedging compliance and documentation requirements and a less costly compliance and reporting regime described in sections V.F.3.c, V.F.3.d, V.F.3.g, and V.F.3.h. The extent to which banking entities may seek to manage down their trading books will depend on a number of factors, such as the size and complexity of each banking entity's trading activities and organizational structure, along with those of its affiliated entities, as well as forms of potential restructuring and the magnitude of expected compliance savings from such restructuring relative to the cost of restructuring. The SEC anticipates that the incentives to manage the trading book under the $20 billion or $1 billion threshold, as applicable, may be strongest for those holding companies that are near or just above the thresholds. Such management of the trading book may reduce the size of trading activity of some banking entities and reduce the number of banking entities subject to more stringent hedging, compliance, and reporting requirements. At the same time, if the amendments incentivize banking entities to have smaller trading books, they may mitigate moral hazard and reduce market impacts from the failure of a given banking entity.

[955] *See, e.g.,* KeyCorp; BMO and Capital One et al.

[956] *See* § ▮▮.6(a)(2).

ii. Efficiency, Competition, and Capital Formation

The 2013 rule imposes compliance burdens that may be particularly significant for smaller market participants. Moreover, such compliance burdens may be passed along to counterparties and customers in the form of higher costs, reduced capital formation, or a reduced willingness to transact. For example, in the proposal, the SEC cited one commenter's estimate that the funding cost for an average non-financial firm may have increased by as much as $30 million after the 2013 rule's implementation.[957] At the same time, and as discussed in section V.F.2, the SEC continues to recognize that the 2013 rule may have yielded important qualitative benefits, such as reducing certain types of risks in the financial system and mitigating potential incentive conflicts that could be posed by certain types of proprietary trading by dealers, as well as enhancing oversight and supervision.

On one hand, as a result of the amendments, Group B and Group C entities might enjoy a competitive advantage relative to similarly situated Group A and Group B entities respectively. As noted, firms that are near to the $20 billion threshold may actively manage their trading book to avoid triggering stricter requirements, and some firms above the threshold may seek to manage down the trading activity to qualify for streamlined treatment under the amendments. As a result, the amendments may result in greater competition between Group B and Group A entities around the $20 billion threshold, and similarly, between Group B and Group C entities around the $1 billion threshold, to the extent that Group C and Group B entities will increase their trading activity without reaching the $1 and $20 billion thresholds respectively. On the other hand, to the extent that the risk exposure of Group B and Group C entities increases as they compete with Group A and Group B entities, respectively, investors may demand additional compensation for bearing financial risk. A higher required rate of return and higher cost of capital could therefore offset potential competitive advantages for Group B and Group C entities.

In addition, the adopted methods for the calculation of limited and significant trading assets and liabilities may result in lower compliance costs for foreign banking entities relative to the domestic banking entities, increasing the competitive advantage of foreign Group B and C entities.

As in the proposal, the SEC recognizes that cost savings to Group B and Group C entities related to the compliance requirements and requirements described in sections V.F.3.g and V.F.3.h may be partially or fully passed along to clients and counterparties. To the extent that hedging documentation and compliance requirements for Group B and Group C entities are currently resulting in a reduced willingness to make markets or underwrite securities, the amendments may facilitate trading activity and risk-sharing, as well as capital formation and reduced costs of access to capital. Again, the SEC notes that the amendments do not eliminate statutory prohibitions under section 13 of the BHC but create a simplified compliance regime for banking entities that do not have significant trading assets and liabilities. Thus, the statutory prohibitions on proprietary trading and covered funds activities will continue to apply to all affected entities, including Group B and Group C entities.

iii. Alternatives

Alternative approaches were considered. For example, the rule could have used other values for thresholds for total consolidated trading assets and liabilities in the definition of entities with significant trading assets and liabilities. As noted in the discussion of the economic baseline, using different thresholds would affect the scope of application of compliance requirements and requirements described in sections V.F.3.g and V.F.3.h by changing the number and size of affected broker-dealers. For instance, using the proposed $10 billion threshold or a lower threshold, such as $5 billion, in the definition of significant trading assets and liabilities would scope a larger number of entities into Group A, as compared to the final rule's $20 billion threshold, thereby subjecting a larger share of the dealer and investment adviser industries to six-pillar compliance obligations. However, the SEC continues to recognize that trading activity is heavily concentrated in the right tail of the distribution and that using a lower threshold would not significantly increase the volume of trading assets and liabilities scoped into the Group A regime.[958] For example, Table 2 shows that 57 bank-affiliated broker-dealers that have between $1 and $10 billion in consolidated trading assets and liabilities and are subject to section 13 of the BHC Act account for only approximately 10% of bank-affiliated broker-dealer assets and between approximately 4% and 9% of holdings. In addition, 33 broker-dealer affiliates of firms that have between $1 and $5 billion in consolidated trading assets and liabilities and are subject to section 13 of the BHC Act account for only approximately 2% of bank-affiliated broker-dealer assets and between approximately 1% and 2% of holdings.[959] At the same time, with a lower threshold, more banking entities would face higher compliance burdens and related costs. Therefore, as discussed in section IV.A.1.b, the agencies decided against this alternative.

A different threshold for the definition of banking entities with limited trading assets and liabilities was also considered. As pointed out by some commenters, a higher threshold, such as $5 billion, would allow small and mid-size banking entities to have moderate growth over time without triggering more costly compliance requirements.[960] As shown in Table 2, 33 more broker-dealers would qualify for presumed compliance under this alternative. However, as discussed in section IV.A.1.b, the agencies continue to believe that banking entities with $1 billion or less in trading assets and liabilities differ from banking entities with between $1 and $5 billion in trading assets and liabilities in their business models and risk exposures, and that a $1 billion threshold appropriately accounts for the risks posed by Group B and Group C entities; therefore, the agencies are not adopting this alternative.

An alternative of splitting banking entities into only two groups according to their trading assets and liabilities—those with significant trading assets and liabilities and those without, *i.e.* joining the limited and moderate trading assets and liabilities groups was also considered.[961] This alternative could have reduced compliance burdens for Group B entities if the threshold was set at $20 billion. But, if the threshold for this alternative would have been set at $1 billion, the compliance burdens for Group B entities would have been

[957] *See* 83 FR at 33526.

[958] Some commenters supported this view. *See, e.g.,* Capital One et al.

[959] In addition, one commenter stated that firms with $20 billion or more in trading assets and liabilities represented approximately 94.80% of total reported U.S. trading assets and liabilities and firms with $5 billion or less in trading assets and liabilities represented approximately 1.32% of total reported U.S. trading assets and liabilities. *See* BPI.

[960] *See, e.g.,* ABA.

[961] This alternative approach was also suggested by some commenters. *See, e.g.,* Capital One et al.

higher than their compliance costs under the final rule. As shown in Table 2, Group B broker-dealers represent approximately 16% of total assets of bank-affiliated broker-dealers and approximately 16% of their holdings, while Group C broker-dealers account for only 4% of total assets of bank-affiliated broker-dealers and 2% of their holdings. The SEC continues to believe that Groups B and C differ in their business models (*e.g.,* level of trading activity) and the risks posed to the U.S. financial system. For these reasons, the agencies decided not to adopt this alternative.

A percentage-based threshold for determining whether a banking entity has significant trading assets and liabilities was also considered. For example, the amendment could have relied exclusively on a threshold where banking entities are considered to be entities with significant trading assets and liabilities if the firm's total consolidated trading assets and liabilities are above a certain percentage (for example, 10% or 25%) of the firm's total consolidated assets. Under this alternative, a greater number of entities could have benefited from lower compliance costs and a streamlined regime for Group B entities. In addition, as pointed out by a commenter, this alternative could address risk for individual banking entities since it would base the threshold on the materiality of trading activity to the entity's business.[962] However, under this approach, even firms in the extreme right tail of the trading asset distribution could be considered without significant trading assets and liabilities if they are also in the extreme right tail of the total assets distribution. Thus, without placing an additional limit on total assets within such regime, entities with the largest trading books could have been scoped into the Group B regime if they also had a sufficiently large amount of total consolidated assets, while entities with significantly smaller trading books could be categorized as Group A entities if they had fewer assets overall. Thus, the SEC believes that this alternative would not have appropriately accounted for the size of banking entities' trading activity.

In addition, a threshold based on total assets could have been adopted. It is possible that losses on small trading portfolios can be amplified through their effect on non-trading assets held by a banking entity. To that extent, a threshold based on total assets may be useful in potentially capturing both direct and indirect losses that originate from trading activity of a holding company.[963] However, such threshold may not be as meaningful as a threshold based on trading assets and liabilities when applied in the context of section 13 of the BHC Act. A threshold based on total assets would scope in entities merely on the basis of their balance sheet size, even though they may have little or no trading activity of the type that section 13 of the BHC Act is intended to address. Therefore, the agencies decided against this alternative.

Thresholds based on the level of total revenues from permitted trading activities could have been adopted. To the extent that revenues could be a proxy for the structure of a banking entity's business and the focus of its operations, this alternative may apply more stringent compliance requirements to those entities that focus their business the most on covered activities. However, revenues from trading activity fluctuate over time, rising during economic booms and deteriorating during crises and liquidity freezes. As a result, under the alternative, a banking entity that is scoped into the regulatory regime during normal times may be scoped out during a time of market stress because of a decrease in the revenues from permitted activities. That is, under such alternative, the weakest compliance regime may be applied to banking entities with the largest trading books in times of acute market stress, when the performance of trading desks is deteriorating and the underlying requirements of the 2013 rule may be the most valuable.

Finally, the agencies could have excluded from the definition of entities with significant trading assets and liabilities those entities that may be affiliated with a firm with over $20 billion in consolidated trading assets and liabilities but that are operated separately and independently and are not consolidated with the parent company that have total trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) under $20 billion. As shown in Table 8 below, the SEC estimates that there are 17 broker-dealers that have holdings of less than $20 billion and are affiliated with bank holding companies that have trading assets and liabilities in excess of $20 billion. The SEC does not have data on how many of these 17 broker-dealers are operated separately and independently and are not consolidated with affiliated entities with significant trading assets and liabilities. However, the SEC notes that, at a maximum, this alternative could decrease the scope of application of the Group A regime for 17 broker-dealers.

TABLE 8—BROKER-DEALER ASSETS AND HOLDINGS, BY GROSS TRADING ASSETS AND LIABILITIES THRESHOLD OF AFFILIATED BANKING ENTITIES

Type of broker-dealer	Number	Total assets, $mln	Holdings, $mln	Holdings (altern.), $mln
Holdings ≥$20bln and affiliated with firms with gross trading assets and liabilities ≥$20bln	19	2,225,989	594,513	514,360
Holdings <$20bln and affiliated with firms with gross trading assets and liabilities ≥$20bln	17	275,951	31,328	13,576
Affiliated with firms with gross trading assets and liabilities <$20bln[964]	163	640,840	135,691	39,451
Total	199	3,142,780	761,532	567,387

Somecommenters indicated that this alternative may be beneficial for banking entities.[965] The SEC recognizes that this alternative would increase the number of entities able to avail themselves of the reduced compliance, documentation, and metrics reporting requirements, potentially resulting in cost reductions flowing through to

[962] *See, e.g.,* KeyCorp.

[963] Some commenters supported this view. *See, e.g.,* Data Boiler.

[965] *See, e.g.,* JBA.

customers and counterparties. At the same time, this alternative would permit more trading activities by entities affiliated with firms that have gross trading assets and liabilities in excess of $20 billion. In addition, it could encourage such firms to fragment their trading activity, for instance, across multiple dealers, and operate them separately and independently, thereby relieving such firms of the requirement to comply with the hedging, compliance, and reporting regime of the 2013 rule. This alternative may, therefore, reduce the regulatory oversight and compliance benefits of the full hedging, documentation, reporting, and compliance requirements for Group A banking entities. The feasibility and costs of such fragmentation would depend, in part, on the organizational complexity of a firm's trading activity, the architecture of trading systems, the location and skillsets of personnel across various dealers affiliated with such entities, and current inter-affiliate hedging and risk mitigation practices.

Some commenters suggested that periodic adjustment to thresholds to account for inflation should be adopted.[966] This alternative would account for changing market conditions in the absence of any changes in a banking entity's business and level of trading activities. In an environment with a moderate level of inflation, Group B and Group C banking entities that are situated just below the thresholds may reduce their level of activity to avoid triggering a more costly compliance regime. However, the agencies do not believe that the additional complexity associated with inflation-indexing the thresholds in the final rule is necessary in light of the other changes to the thresholds and calculation methodologies described above. Therefore, the agencies decided against this alternative.

b. Proprietary Trading

Under section 13 of the BHC act and the 2013 rule, proprietary trading is defined as engaging as principal for the ''trading account'' of a banking entity.[967] Thus, the definition of the trading account determines the trading activity that falls within the scope of the statutory prohibitions and the compliance regime in the 2013 rule associated with such activity. The definition of trading account in the 2013 rule has three prongs, including the dealer prong. The final amendments introduce certain changes to the definition of trading account; however, these amendments do not remove or modify the dealer prong. In addition, the amendments introduce new exclusions from the trading account and a new definition of the trading desk.

i. Trading Account

(1) Costs and Benefits

Under the final rule, the definition of ''trading account'' continues to include purchases and sales of financial instruments by banking entities engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent these instruments are purchased or sold in connection with the activities of such business.[968] Thus, the SEC expects that most (if not substantially all) trading activity by SEC-regulated dealers that are banking entities will continue to be captured by the dealer prong of a banking entity, notwithstanding any of the changes made to the definition of the trading account.

Some commenters pointed out that not all of dealers' trading activity is conducted in a dealer capacity.[969] The SEC recognizes the possibility that some dealers engage in transaction activity that, by itself, would not trigger a dealer registration requirement.[970] Under the baseline, such activity may be scoped into the ''trading account'' definition by the short-term prong or the market risk capital prong. Thus, as discussed below, the SEC believes that only a small subset of trading activity by dealers may be affected by the changes to the definition of the trading account.

The agencies are adopting three changes to the definition of the trading account. First, the applicability of the short-term prong and the market risk capital prong is changed under the final rule. In particular, for dealers that are subject to the market risk capital prong, trading activity outside of the dealer prong will be scoped into the trading account only if it is a covered position for the purposes of the market risk capital rule. That is, if the activity is not captured by the dealer prong or the market risk capital prong, it would be scoped out from the definition of the trading account under the final rule. This is in contrast to the 2013 rule, under which, for banking entities that are subject to the market risk capital prong, trading activity that is not captured by the dealer prong or the market risk capital prong could still be captured by the short-term prong.[971] Thus, under the 2013 rule, bank dealers that are subject to the market risk capital prong have to apply three prongs: The dealer prong, the market risk capital prong, and the short-term prong. Under the final rule, these same entities will apply only two prongs: The dealer prong and the market-risk capital prong. To the extent that dealers subject to the market risk capital prong have trading activities that are not captured by the dealer prong currently experience organizational inefficiencies or duplicative costs as a result of being subject to both short-term and market risk capital prongs, this amendment may benefit such dealers by decreasing their compliance costs, as discussed in section V.F.3.g, and decreasing the regulatory complexity, consequently increasing operational efficiency. The SEC expects that these benefits are likely to be greater for banking entities that are not subject to the dealer prong, although, as noted above, the SEC does not analyze those potential benefits here.

In addition, to the extent that the definition of trading account in the 2013 rule involves position-by-position analysis of financial instruments which may be costly, and to the extent that the costs of such analysis discourage dealers that are subject to the market risk capital prong from conducting activities that could be scoped in by the short-term intent prong, this amendment may promote trading activities that would not be captured by the dealer prong or the market risk capital prong. On the one hand, such trading activities may allow dealers that are subject to the market risk capital rule to manage their business more efficiently. On the other hand, to the extent that, under the final rule, trading activity that is not captured by either the dealer prong or the market risk capital prong would have been captured by the short-term intent prong, and to the extent that this activity exposes dealers to additional risks, this amendment may increase risk exposure of dealers that are subject to the market risk capital rule. The SEC does not have information about the amount of trading activity of SEC-registered broker-dealers

[964] This category excludes SEC-registered broker-dealers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, as well as firms for which bank trading assets and liabilities data was not available.

[966] *See, e.g.,* BPI and Capital One et al.

[968] *See* 2013 rule § ▮▮.3(b)(1)(iii).

[969] *See, e.g.,* SIFMA and BPI.

[970] *See* 79 FR at 5549 (''The Agencies believe the scope of the dealer prong is appropriate because, as noted in the proposal, positions held by a registered dealer in connection with its dealing activity are generally held for sale to customers upon request or otherwise support the firm's trading activities (*e.g.,* by hedging its dealing positions), which is indicative of short term intent.'').

[971] As noted in section IV.B.1.a.iii, the scope of activities captured by the short-term intent prong substantially overlaps with the scope of activities captured by the market risk capital prong.

that is not captured by the dealer prong or the market risk capital prong and about the prevalence of the current application of the market risk capital prong and the short-term prong under the 2013 rule. As shown in Table 9 below, the SEC estimates that there are 100 broker-dealers that in aggregate hold between 98% and 99% of holdings by broker-dealers affected by the final rule that are subject to the market risk capital rule and may be affected by this amendment. The SEC continues to believe that the largest share of dealers' trading activity will continue to be captured by the dealer prong. Thus, the SEC expects that the effects of this amendment on SEC-regulated dealers will be modest.

TABLE 9—MARKET RISK CAPITAL RULE APPLICATION

Market risk capital rule application	Number of broker-dealers	Total assets, $mln	Holdings	Holdings (altern.)
Subject to the market risk capital rule	100	3,002,834	749,867	562,515
Not subject to the market risk capital rule	99	139,946	11,665	4,872
Total	199	3,142,780	761,532	567,387

The second change to the definition of trading account affects banking entities that are not subject to the market risk capital rule and cannot apply the market risk capital prong under the 2013 rule. Under the final rule, these entities will be able to elect to apply the market risk capital prong instead of the short-term prong to determine the scope of the banking entity's trading account. This amendment will affect those dealers that have trading activity that is not captured by the dealer prong and instead captured by the short-term prong. To the extent that the market risk capital prong is less costly to comply with, relative to the short-term prong, this amendment may benefit dealers that are not subject to the market risk capital rule and have trading activity that is not captured by the dealer prong by providing them with flexibility to apply the prong that is more cost-effective. This amendment may particularly benefit foreign banking entities that are not subject to the market risk capital rule but are applying a different market risk framework, to the extent that this framework is similar to the market risk capital rule. To the extent that foreign dealers with frameworks similar to the framework of the market risk capital rule are currently experiencing inefficiencies because they cannot apply the market risk capital prong of the trading account definition, this amendment may reduce the compliance costs of these dealers. The SEC estimates that, at most, 99 broker-dealers that are not subject to the market risk capital rule may be affected by this amendment, to the extent that they have trading activity that is captured by the short-term prong under the 2013 rule. However, the SEC continues to believe that the largest share of dealers' trading activity will continue to be captured by the dealer prong. Thus, the SEC expects that the effects of this amendment for dealers will be modest.

The third amendment to the trading account definition will eliminate the 60-day rebuttable presumption in the short-term prong and instead establish a new rebuttable presumption that financial instruments held for 60 days or more are not within the short-term prong. Many commenters supported the proposed rule's elimination of the 60-day rebuttable presumption,[972] and some commenters suggested that the agencies should presume, for banking entities not subject to the market risk capital rule, that financial instruments held for longer than 60 days, or that have an original maturity or remaining maturity upon acquisition, of fewer than 60 days to their stated maturities, are not for the banking entity's trading account.[973] As recognized in section IV.B.1.a.iv, the agencies have found that the rebuttable presumption has captured many activities that should not be included in the definition of proprietary trading. In addition, as stated by some commenters, the presumption may be difficult to rebut.[974] Therefore, the SEC believes that the reversal of the presumption in the 2013 rule would reduce the compliance burdens for dealers that conduct trading activity that is not otherwise captured by the dealer prong or the market risk capital prong. To the extent that the compliance burdens related to the rebuttable presumption of the 2013 rule limit dealers' ability to conduct customer-accommodating transactions or liquidity management activities, the cost reductions of the amendment may flow through to customers and counterparties and increase operational efficiency of dealers. The SEC estimates that this amendment may affect 99 broker-dealers—the broker-dealers that are not subject to the market risk capital rule—which on aggregate have 1.5% of broker-dealer holdings. However, the SEC expects that the largest share of dealing activity subject to SEC oversight will continue to be captured by the dealer prong. Thus, the SEC expects that the effects of this amendment for dealers will be modest.

(2) Efficiency, Competition, and Capital Formation

To the extent that the compliance related to the rebuttable presumption of the 2013 rule limits dealers' ability to conduct customer-accommodating transactions, or liquidity management or risk management activities that are covered by the short-term prong, the amendments to the definition of trading account may facilitate such activities, which could, in turn, promote capital formation. In addition, to the degree that the amendments to the trading account may provide banking entities with more flexibility to underwrite, market make, and hedge, and to the extent these activities facilitate capital formation, these amendments may improve allocative efficiency. To the extent that the amendments to the short-term prong reduce compliance costs and to the extent that the short-term prong primarily applies to smaller dealers (*i.e.,* those not covered by the market risk capital prong), the amendments to the trading account definition may improve the competitive position of smaller dealers. However, the SEC notes that the largest share of dealing activity subject to SEC oversight is already captured by the dealer prong; and, therefore, the above economic effects of the amendments to the definition of the trading account on SEC-regulated entities, including the effects on efficiency, competition, and capital formation, may be de minimis.

[972] *See, e.g.,* State Street; Chatham; BPI; FSF; CCMR and CFA.

[973] *See, e.g.,* ABA; Arvest; BPI; SIFMA and IIB.

[974] *See, e.g.,* State Street; Chatham; BPI; FSF; CCMR and CFA.

(3) Alternatives

As an alternative to the short-term prong, the agencies proposed replacing the short-term prong in the 2013 rule with an accounting prong that would have included within the definition of ''trading account'' any account used by a banking entity to purchase or sell one or more financial instruments that are recorded at fair value on a recurring basis under applicable accounting standards.[975] As the agencies noted when they proposed this alternative, the accounting prong was designed to provide more certainty and clarity about which financial instruments should be included in the trading account due to the fact that banking entities should know which positions are recorded at fair value on their balance sheets.[976] In addition, as pointed out by some commenters,[977] this alternative could deter noncompliance and facilitate the agencies' supervision. However, a large number of commenters stated that the proposed accounting prong would inadvertently scope in activities that are not principally for the purpose of selling in the near term or otherwise with the intent to resell in order to profit from short-term price movements. For example, some commenters pointed out that longer term positions, such as available-for-sale debt securities,[978] certain long-term investments,[979] static hedging of long term investments,[980] traditional asset-liability management activities,[981] derivative transactions entered into for any purpose and duration,[982] long-term holdings of commercial mortgage-backed securities; [983] would be scoped in under this alternative. Although some of these instruments are held for less than 60 days and may fall under the short-term prong of the trading account under the 2013 rule, these instruments, in general, are not held for trading purposes, *i.e.,* they are not held principally for the purpose of selling in the near term; rather, the majority of the aforementioned instruments are held for investment.[984] Since this alternative would include all instruments reported at fair value, regardless of the purpose with which these instruments are bought or sold and regardless of the period during which these instruments are held (short-term or long-term), the scope of the trading account would be significantly greater under this alternative than the scope of the trading account in the 2013 rule. Given that many of the instruments that would be captured by the accounting prong are not held principally for the purpose of selling in the near term, the agencies are not adopting this alternative. The SEC also notes that if this alternative had been adopted, the effect on SEC-regulated dealers would have been limited because the majority of dealer trading activity falls under the dealer prong.

The agencies also proposed, but are not adopting, including a reservation of authority allowing for a determination, on a case-by-case basis, with appropriate notice and response procedures, that any purchase or sale of one or more financial instruments by a banking entity for which it is the primary financial regulatory agency either is or is not for the trading account. While the SEC continues to recognize that the use of objective factors to define proprietary trading is intended to provide bright lines that simplify compliance, the SEC also recognizes that this approach may, in some circumstances, produce results that are either underinclusive or overinclusive with respect to the definition of proprietary trading. The SEC continues to believe that the reservation of authority may add uncertainty for banking entities about whether a particular transaction could be deemed as a proprietary trade by the regulatory agency, which may affect the banking entity's decision to engage in transactions that are not included in the definition of the trading account under the 2013 rule. As discussed in the proposal, notice and response procedures related to the reservation of authority provision would cost as much as $19,877 for SEC-registered broker-dealers, and $5,006 for entities that may choose to register with the SEC as SBSDs.[985]

The agencies proposed but are not adopting the revision of the market risk capital prong to apply to the activities of FBOs to take into account the different market risk frameworks FBOs may have in their home countries.[986] This alternative may better align foreign banking entities' compliance with the 2013 rule and compliance with market risk regulations of their home counties, increasing organizational efficiency and potentially decreasing compliance costs for such banking entities. However, as suggested by some commenters, under this alternative, positions that are not held for short-term trading would be captured in some foreign market risk capital frameworks.[987] Therefore, the agencies decided against this alternative and instead are adopting a more flexible approach, under which foreign banking entities would be able to apply the market risk capital prong if they choose to do so.[988]

As an alternative, the agencies could have modified the dealer prong of the trading account definition to include only near-term trading, *e.g.,* positions held for less than 60, 90, or 120 days. This alternative would likely narrow the scope of application of the substantive proprietary trading prohibitions to a smaller portion of a banking entity's activities. Under this alternative, bank-affiliated dealers would be able to amass large trading positions at the near-term definition boundary (*e.g.,* for 61, 91, or 121 days) to take advantage of a directional market view, to profit from mispricing in an instrument, or to collect a liquidity premium in a particular instrument. This may significantly increase the risk exposure of bank-affiliated dealers. However, as this alternative could stimulate an increase in potentially impermissible proprietary trading by these dealers, the volume of trading activity in certain instruments and liquidity in certain markets may increase. The SEC also notes that the temporal thresholds necessary to implement such a short-term trading alternative would be difficult to quantify and may have to vary by product, asset class, and aggregate market conditions, among other factors. For instance, the markets for large cap equities and investment grade corporate bonds have different structures, types of participants, latency of trading, and liquidity levels. Therefore, an appropriate horizon for short-term positions will likely vary across these markets. Similarly, the ability to transact quickly differs under strong macroeconomic conditions and in times of stress. A meaningful implementation of this alternative would likely require calibrating and

[975] *See* proposed rule § ▮▮.3(b)(3); 83 FR at 33447–48.

[976] *See id.*

[977] *See, e.g.,* Better Markets.

[978] *See, e.g.,* BPI and SIFMA.

[979] *See, e.g.,* Capital One et al.; BPI; SIFMA; and CCMR.

[980] *See, e.g.,* BPI and ISDA.

[981] *See, e.g.,* KeyCorp; BPI; Capital One et al.; FSF and Goldman Sachs.

[982] *See e.g.,* ISDA and BPI.

[983] *See* MBA.

[984] *See, e.g.,* FASB defines available-for-sale securities as investments that are not classified as trading securities nor as held-to-maturity securities and states that cash flows from these investments should be classified as cash flows from investing activities. *See* ''Statement of Financial Accounting Standards No. 115'', FASB.

[985] *See* 83 FR 33432.

[986] *See* proposed rule § ▮▮. 3(b)(1)(ii); 83 FR at 33447.

[987] *See, e.g.,* IIB.

[988] *See* section IV.B.1.a.v.

recalibrating complex thresholds to exempt non-near-term proprietary trading and so could introduce additional uncertainty and increase the compliance burdens on SEC-regulated banking entities.

As another alternative, the agencies could have categorically excluded financial instruments of dealers purchased in a non-dealing capacity, such as financial instruments purchased for long-term investment purposes. Some commenters pointed out that it is not always clear whether such instruments are scoped in the dealer prong and that banking entities may engage in costly and time-consuming position-by-position analysis to confirm that a long-term investment is captured in the trading account.[989] As discussed in section IV.B.1.a.vi, the agencies continue to believe that only the activities that are done in connection with activities that would require the banking entity to be licensed or registered are covered by the dealer prong. For example, if a banking entity purchases or sells a financial instrument in connection with activities that do not require registration as a dealer, this activity would not be covered by the dealer prong. However, this activity could still be included in the trading account under the short-term prong or the market risk capital prong, as applicable.[990]

ii. Exclusions From Proprietary Trading

The agencies are adopting the proposed expansion of the liquidity management exclusion, as well as an exclusion for trading errors and subsequent correcting transactions, certain matched derivative transactions, certain trades related to hedging mortgage servicing rights or mortgage servicing assets, and transactions in instruments not included in the definition of trading asset or trading liability under the applicable reporting form for a banking entity.

(1) Costs and Benefits

Exclusion for Liquidity Management Activities

The agencies are adopting the proposed expansion of the liquidity management exclusion substantially as proposed, but with a modification to permit the use of non-deliverable cross-currency swaps. Thus, liquidity management exclusion would apply not only to securities, but also to foreign exchange forwards and foreign exchange swaps (each as defined in the Commodity Exchange Act), and to cross-currency swaps (both physically- and cash-settled) that are traded for the purpose of liquidity management in accordance with a documented liquidity management plan. On the one hand, under this amendment, SEC-regulated banking entities would face lower burdens and enjoy greater flexibility in currency-risk management as part of their overall liquidity management plans. In the proposal, the SEC recognized that the liquidity management exclusion in the 2013 rule may be narrow and that the trading account definition may scope in routine asset-liability management and commercial-banking related activities. In their response to the proposal, some commenters supported that view and stated that the 2013 rule may be restricting liquidity-risk management by banking entities.[991] Therefore, the SEC continues to believe that, to the degree that these effects constrain activities of dealers, this amendment could facilitate more efficient risk management, greater secondary market activity, and more capital formation in primary markets.

Some commenters indicated that this amendment may make it easier to trade in currency markets for speculative purposes under the guise of legitimate liquidity management.[992] The SEC continues to recognize that this liquidity-management amendment may lead to currency derivatives exposures, including potentially very large exposures, being scoped out of the trading account definition and the ensuing substantive prohibitions of the 2013 rule, which may increase the risk exposures of banking entities and reduce the effectiveness of regulatory oversight. However, the SEC continues to believe that the conditions maintained in the exemption, including the requirement to conduct liquidity management in accordance with a documented liquidity management plan, will limit these adverse effects.

Exclusion for Error Trades

The agencies are also adopting an exclusion for trading errors and subsequent correcting transactions from the definition of proprietary trading. The 2013 rule excludes from the proprietary trading prohibition certain excluded clearing activities by banking entities that are members of clearing agencies, derivatives clearing organizations, or designated financial market utilities. Specifically, such excluded clearing activities are defined to include, among others, any purchase or sale necessary to correct error trades made by, or on behalf of, customers with respect to customer transactions that are cleared, provided the purchase or sale is conducted in accordance with certain regulations, rules, or procedures.[993] Accordingly, the exclusion for error trades under the 2013 rule is applicable only to clearing members with respect to cleared customer transactions.[994]

[989] *See, e.g.,* SIFMA and BPI.

[990] *See* 79 FR 5549.

[991] *See, e.g.,* ISDA; Goldman Sachs and SIFMA.

[992] *See* Volcker Alliance and Data Boiler.

[993] *See* 2013 rule § ▮▮.3(e)(7).

[994] *Id.*

This amendment primarily benefits dealers that are not clearing members with respect to all customer trades and dealers that are clearing members with respect to customer trades that are not cleared, since under the 2013 rule error trades of these dealers are not considered excluded clearing activity. Table 10 reports information about broker-dealer count, assets, and holdings, by affiliation and clearing type.

TABLE 10—BROKER-DEALER ASSETS AND HOLDINGS, BY CLEARING STATUS [995]

Broker-dealers subject to section 13 of the BHC Act	Number	Total assets, $mln	Holdings, $mln	Holdings (altern.), $mln
Clear or carry (or both)	76	3,101,936	755,975	562,649
Other	123	40,844	5,557	4,738
Total	199	3,142,780	761,532	567,387

Since correcting error trades is not conducted for the purpose of profiting from short-term price movements, as also pointed out by some commenters,[996] this amendment is likely to facilitate valuable customer-facing activities and promote effective risk management by dealers. As discussed in section IV.B.1.b.ii, the agencies continue to believe that banking entities generally should monitor and manage their error trade account because doing so would help prevent personnel from using these accounts for proprietary trading. Some commenters stated that banking entities could still make profits while relying on the error trade exclusion.[997] To the degree that this may happen, banking entities could become incentivized to use error trade exclusion to conduct proprietary trading. However, some commenters noted that bona fide trade error activity is separately managed and classified as an operational loss when there is a loss event or a near miss when error activity results in a gain.[998] The SEC agrees with the commenters' view and believes that existing requirements and operational risk management practices would be sufficient to deter participants from using the error trade exclusion to obfuscate impermissible proprietary trades.

Exclusion for Customer-Driven Swaps and Customer-Driven Security-Based Swaps

In addition, the agencies are adopting an exclusion for transactions in which banking entities contemporaneously enter into a customer-driven swap or security-based swap and a matched swap or security-based swap if (i) the banking entity retains no more than minimal price risk; and (ii) the banking entity is not a registered dealer, swap dealer, or security-based swap dealer. The SEC continues to recognize that loan-related swaps and customer accommodation back-to-back derivatives facilitate lending transactions as a customer service and are not designed to profit from speculative price movements.[999] Some commenters indicated that such customer accommodation loan-related swaps transactions may reduce the risk of banking entities and borrowers, and encourage the extension of credit, commonly for smaller and medium-size banking entities that engage in trading in connection with loans and other extensions of customer credit. Some commenters stated that this amendment increases the scope of permissible trading activity. The SEC notes that under the final rule this exclusion is not available to banking entities that are subject to the market risk or the dealer prong, reducing such risks. Therefore, the SEC believes that the effects of this amendment discussed above on SEC-regulated entities would be de minimis.

Exclusion for Hedges of Mortgage Servicing Rights or Mortgage Servicing Assets

The agencies are adopting an exclusion for transactions involving any purchase or sale of one or more financial instrument that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy. This amendment will provide more clarity to banking entities that are subject to the short-term prong that intangibles, including servicing assets, are not included in the definition of proprietary trading. Because under the market risk capital prong, intangibles, including servicing assets, are explicitly excluded from the definition of "covered position," the exclusion will provide additional certainty to dealers that do not apply the market risk capital prong. To the extent that dealers that do not apply the market risk capital prong currently experience uncertainty as to whether the aforementioned financial instruments are included in the trading account and to the extent that this uncertainty impedes transactions involving these types of financial instruments, the amendment may facilitate permitted trading activity in these financial instruments. In addition, to the extent that these exclusions facilitate more efficient risk management, dealers that are not subject to the market risk capital rule may benefit from this amendment.[1000]

Exclusion for Financial Instruments That Are Not Trading Assets or Trading Liabilities

In addition to the above exclusions, the agencies are adopting an exclusion for purchases or sales of financial instruments that do not meet the definition of trading assets or trading liabilities under the applicable reporting form for a banking entity as of January 1, 2020. Similar to the exclusion for hedges of mortgage servicing rights or assets, this exclusion is intended to clarify the scope of the prohibition on proprietary trading and to provide parity between banking entities that apply the market risk capital prong and banking entities that apply the short-

[995] Broker-dealers clearing or carrying customer accounts (or both) are identified using FOCUS filings. Broadly, broker-dealers that are clearing or carrying firms directly carry customer accounts, maintain custody of the assets, and clear trades. Other broker-dealers may accept customer orders but do not maintain custody of assets. This analysis excludes SEC-registered broker-dealers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, as well as firms for which bank trading assets and liabilities data was not available.

[996] *See, e.g.,* BPI; FSF and BB&T.

[997] *See, e.g.,* Data Boiler; CAP and Public Citizen.

[998] *See, e.g.,* ABA; BB&T; BPI and Capital One et al.

[999] Commenters agreed with this view. *See, e.g.,* Covington; Credit Suisse; SIFMA; Chatham and ABA.

[1000] The SEC estimates that there are 99 SEC-registered broker-dealers that are not subject to the market risk capital rule, which on aggregate hold approximately 1.5% of broker-dealer holdings.

term intent prong by scoping out of the rule positions that would not be captured by the market risk capital prong. In addition, this amendment will exclude financial instruments purchased by a dealer in its dealing capacity that are not trading assets or liabilities. Therefore, the SEC believes that this amendment will benefit dealers, to the extent that the 2013 rule's dealer prong is overinclusive because it scopes in financial instruments acquired in dealer capacity, regardless of their purpose (*i.e.* both for trading and non-trading purposes). To the extent that this aspect of the 2013 rule leads to inefficiencies or increases costs at the dealer level, the SEC expects that the final rule will promote dealers' organizational efficiency by narrowing the scope of the dealer prong to financial instruments that are considered trading assets and liabilities.

To the extent that some financial instruments that are not trading assets or liabilities are currently scoped-into the rule by the short-term prong due to the fact that they are held for less than 60 days, this amendment may decrease the scope of the trading account. For example, some fair value financial instruments that are not trading assets or liabilities, such as available-for-sale securities or derivatives not reported as trading, may be held for less than 60 days and therefore be presumed to be for the trading account under the 2013 rule. However, under the 2013 rule, banking entities could rebut this presumption by demonstrating that such instruments are not purchased or sold principally for the purpose of selling in the near term.[1001] In addition, the SEC notes that dealers, in general, hold primarily trading assets and trading liabilities due to the nature of their business. The SEC does not have data or information about what fraction of dealers' financial instruments that are not defined as trading assets or liabilities under the applicable banking agency reporting forms is currently being scoped-into the trading account by the short-term prong in the 2013 rule. This is because only non-trading fair value instruments held for fewer than 60 days are likely to be scoped into the trading account via the short-term prong under the 2013 rule, rather than all such financial instruments, and the data disaggregated by maturity of non-trading fair value instruments is not available. However, the SEC reiterates that only a small subset of trading activity by dealers may be affected by this exclusion, as majority of financial instruments purchased or sold by dealers are trading assets and liabilities. For this reason and the reasons discussed above, the SEC expects that this amendment will not substantially affect the scope of the trading account for banking entities that are dealers.

(2) Efficiency, Competition, and Capital Formation

To the degree that the 2013 rule may be restricting liquidity-risk management by banking entities, and to the extent that this affects their trading activity, the liquidity management amendment could facilitate more efficient risk management, greater secondary market activity, and more capital formation in primary markets. Similarly, to the extent that corrections for bona-fide errors and exclusions for customer-driven swaps and customer-driven security-based swaps and transactions related to mortgage servicing rights facilitate customer-driven transactions and increase banking entities' willingness to conduct such transactions, these exclusions could facilitate more efficient risk management and promote capital formation and secondary market activity. In addition, to the degree that the exclusions from proprietary trading may provide banking entities with more flexibility to manage risks, and to the extent these activities facilitate capital formation, these amendments may improve allocative efficiency.

To the extent that these amendments may increase the ability of dealers that are banking entities to hedge risks related to customer transactions, the competitive position of dealers that are banking entities may improve relative to nonbanking dealers. In addition, to the extent that these amendments reduce compliance costs of dealers that are banking entities and to the extent that these compliance costs are currently passed onto customers and counterparties, the reduction in costs related to the exclusions from proprietary trading may result in more competitive prices set by dealers that are banking entities, improving their competitive position further.

(3) Alternatives

The agencies could have taken the approach of expanding the liquidity management exclusion to exclude additional trading activities. For example, the agencies could exclude transactions in other derivatives, such as derivatives related to government securities, derivatives on foreign sovereign debt,[1002] instruments that qualify for certain treatment under the liquidity coverage ratio or section 165 of the Dodd-Frank Act, or transactions executed by SEC-registered dealers on behalf of their asset management customers.[1003]

The 2013 rule exempts all trading in domestic government obligations and trading in foreign government obligations under certain conditions; however, derivatives referencing such obligations that are intended to manage risks—including derivatives portfolios that can replicate the payoffs and risks of such government obligations—are not excluded from the trading account. Therefore, existing requirements reduce the flexibility of banking entities to engage in asset-liability management and result in a different treatment of two groups of financial instruments that have similar risks and payoffs. Excluding derivatives transactions on government obligations from the trading account definition could reduce costs to market participants and provide greater flexibility in their asset-liability management. This alternative could also result in increased volume of trading in markets for derivatives on government obligations, such as Treasury futures. The SEC recognizes, nonetheless, that derivatives portfolios that reference an obligation, including Treasuries, can be structured to magnify the economic exposure to fluctuations in the price of the reference obligation. Moreover, derivatives transactions involve counterparty credit risk not present in transactions in reference obligations themselves. Since the alternative would exclude all derivatives transactions on government obligations, and not just those that are intended to mitigate risk, this alternative could permit banking entities to increase their exposure to counterparty, interest rate, and liquidity risk. For the reasons discussed in section IV.B.1.i, the agencies decided not to expand the liquidity management exclusion further.

The agencies also considered mandating the use of a separately-managed trade error account for the purposes of this amendment. This alternative could deter banking entities from using the error trade exclusion to obfuscate impermissible proprietary trades. However, as indicated by the commenters, this approach may result in duplicative systems and additional

[1001] As discussed above, the final rule eliminates the 60-day rebuttable presumption in the short-term prong and instead establishes a new rebuttable presumption that financial instruments held for 60 days or more are not within the short-term prong.

[1002] Some commenters indicated that all derivatives should be excluded in the liquidity management exclusion. *See, e.g.,* FSF; Capital One et al.; IIB and JBA.

[1003] *See, e.g.,* Capital One et al. and ABA.

compliance costs.[1004] The agencies agree with these commenters and, therefore, are not adopting this alternative.

iii. Trading Desk Definition

The final rule adopts a multi-factor definition of the trading desk that is substantially similar to the definition included in the request for comment in the proposal, except that the reference to incentive compensation has been removed from the first prong. The definition of trading desk includes a new second prong that aligns the definition with the market risk capital rule. Specifically, for a banking entity that is subject to the market risk capital rule, the trading desk established for purposes of the market risk capital rule must be the same unit of organization that is established as a trading desk for purposes of the regulations implementing section 13 of the BHC Act.

(1) Costs and Benefits

The SEC continues to recognize that the definition of trading desk is an important component of the implementation of the 2013 rule in that certain requirements, such as those applicable to the underwriting and market making exemptions, and the metrics-reporting requirements, apply at the trading desk level of organization. Under the 2013 rule, a trading desk is defined as the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof. Some commenters asserted that the smallest discrete unit language of the 2013 rule was subjective, ambiguous, or could be interpreted in different ways.[1005] Thus, the SEC continues to believe that SEC-regulated banking entities may currently experience substantial compliance costs related to the trading desk designation for the purposes of compliance with section 13 of the BHC Act. Accordingly, the SEC believes that the adopted definition of the trading desk may provide more certainty to SEC-regulated banking entities regarding trading desk designations and will reduce their compliance burdens, as the multi-factor definition better aligns with other operational, management, and compliance purposes,[1006] which typically depend on the type of trading activity, asset class, product line offered, and individual banking entity's structure. Among the metrics submissions from 18 entities received by the SEC, the SEC estimates that the average number of desks reported per entity is approximately 51.[1007] To the extent that the trading desk designations under the final rule will be less granular than those under the 2013 rule, and to the extent that establishing a large number of desks is more costly, this amendment will reduce compliance costs for dealers that are banking entities.

As seen in Table 9, the SEC estimates that 100 broker-dealers with between 98% and 99% of holdings are currently subject to the market risk capital rule and would be able to align their trading desks for the purposes of the Volcker Rule and the market risk capital rule. The SEC continues to believe that such alignment will reduce organizational complexity, consequently reducing compliance burdens for these banking entities.[1008] The SEC also estimates that 99 broker-dealers are not currently subject to the market risk capital rule—these broker-dealers will be able to establish trading desks on the basis of the multi-factor definition. To the extent that the current operational, management, or compliance structure of these entities may not perfectly align with the adopted multi-factor definition of the trading desk, these entities may experience one-time setup costs related to the reorganization of trading activity in order to satisfy the multi-factor definition. The SEC does not have information or data about the costs of this reorganization. However, the SEC believes that these reorganization costs will be offset by a reduction in ongoing compliance costs, which will be reduced as a result of the amended definition of the trading desk for dealers that are not subject to the market risk capital rule, to the extent that the trading desk designations under the final rule will be less granular than those under the 2013 rule and will better align with criteria used to establish trading desks for operational and management purposes.

(2) Efficiency, Competition, and Capital Formation

To the extent that the reduction in compliance costs stemming from this amendment facilitates permitted trading activity by banking entities, capital formation may increase. To the extent that the reduced compliance costs stemming from this amendment flow through to customers and counterparties, bank-affiliated dealers may become more competitive with nonbanking dealers. The amendment to the definition of the trading desk does not change the information available to market participants, and the SEC does not believe that these amendments are likely to have an effect on informational efficiency. To the degree that this amendment facilitates capital formation, allocative efficiency may improve.

(3) Alternatives

The agencies could have adopted an amendment that would allow trading desks to be set completely at the discretion of banking entities.[1009] This would provide banking entities greater flexibility in determining their own optimal organizational structure and allow banking entities organized with various degrees of complexity to reflect their organizational structure in the trading desk definition. This alternative could reduce operational costs from fragmentation of trading activity and compliance program requirements, as well as enable more streamlined metrics reporting. However, under this alternative, a banking entity may be able to aggregate impermissible proprietary trading with permissible activity (*e.g.,* underwriting, market making, or hedging) into the same trading desk and consequently take speculative positions under the guise of permitted activities. To the extent that this alternative would allow banking entities to use a highly aggregated definition of a trading desk, it may increase risk exposures of banking entities and the conflicts of interest that the prohibitions of section 13 of the BHC Act aimed to address.[1010] The SEC does not have data on operating and compliance costs that arise because of the fragmentation of trading activity by SEC-regulated banking entities, or data on their organizational complexity, and the extent of variation therein. For the reasons discussed in section IV.B.1.c, the agencies are not adopting this definition.

c. Permitted Underwriting and Market Making

Underwriting and market making are customer-oriented financial services that are essential to capital formation and market liquidity, and the risks and profit sources related to these activities are distinct from those related to impermissible proprietary trading. Moreover, as discussed above, market liquidity can be important to investors

[1004] *See, e.g.,* ABA; Credit Suisse; JBA and SIFMA.

[1005] *See, e.g.,* ABA and CCMC.

[1006] This was also supported by commenters. *See, e.g.,* ABA; JBA; FSF; Goldman; ISDA; SIFMA and CCMC.

[1007] *See* section V.0.

[1008] *See id.*

[1009] This alternative was also suggested by a commenter. *See* JBA.

[1010] *See, e.g.,* Volcker Alliance.

as it may enable investors to exit (in a timely manner and at an acceptable price) from their positions in instruments, products, and portfolios. At the same time, excessive risk exposure by banking entities can, of course, adversely affect markets and, therefore, investors.

Under the final rule, banking entities with covered activities are presumed compliant with the RENTD requirements of the exemption for underwriting and market making-related activities if the banking entity establishes and implements, maintains, and enforces certain internal limits that are designed not to exceed RENTD, taking into account the liquidity, maturity, and depth of the market for the relevant type of security or financial instrument. These internal limits are subject to supervisory review and oversight on an ongoing basis.

For Group A entities, these limits are required to be established either within the entity's internal compliance program or under the presumption of compliance within the exemptions for permitted underwriting and market making related activities. Under the final rule, Group B entities are not required to establish a separate compliance program for underwriting and market making requirements, including the internal limits for RENTD. However, in order to be presumed compliant with the RENTD requirements under the exemptions for underwriting and market making-related activities, banking entities are required to establish and enforce limits designed not to exceed RENTD, as well as authorization procedures for limit breaches and increases for each trading desk as described below.

With respect to limit increases and breaches, banking entities are required to maintain and make available upon request records regarding any limit that is exceeded and any temporary or permanent increase to any limit. Unlike the proposal, the final rule does not include the requirement of prompt reporting of breaches or limit increases but requires that banking entities keep and provide such records to the agencies upon request. However, consistent with the requirements under the 2013 rule, the final rule includes certain requirements for the continued availability of the presumption of compliance in the event of limit increases or breaches. Specifically, the presumption of compliance will continue to remain available in the event of a breach or limit increase only if (i) the banking entity takes prompt action to bring the trading desk into compliance; and (ii) establishes and complies with a set of written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limits, demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limits, and independent review of such demonstrable analysis and approval.

i. Costs and Benefits

This section discusses the expected benefits of the final rule and how regulatory oversight of internal limits may reduce such benefits; potential costs related to deterioration of risk management practices and increased risk exposures of banking entities, including with respect to the removal of the demonstrability requirement; aspects of the final rule and baseline that mitigate these costs; and factors likely to affect the overall balance of these economic effects.

The primary expected benefits of the final rule are threefold. First, the agencies have received comments that the 2013 rule has created significant costs and uncertainty about some banking entities' ability to rely on the exemption for underwriting and market making-related activities,[1011] and the economic baseline discusses existing research on the baseline effects of the 2013 rule on market quality, trading, and client facilitation activities. The SEC believes that the final rule may provide SEC-regulated banking entities with beneficial flexibility and certainty in conducting permissible underwriting and market making-related activities. Second, consistent with commenter views,[1012] the SEC recognizes that banking entities may already routinely establish and monitor internally set risk and position limits for purposes of meeting capital requirements and internal risk management. Thus, to the degree that some banking entities already establish limits that meet the requirements under the final rule, the presumption allows the reliance on internal limits in accordance with a banking entity's risk management function that may already be used to meet other regulatory requirements. Therefore, the amendment may prevent unnecessary duplication of risk-management compliance procedures for the purposes of complying with multiple regulations and may reduce compliance costs for SEC-regulated banking entities. Third, to the extent that the uncertainty and compliance burdens related to the RENTD requirements are currently impeding otherwise profitable permissible underwriting and market making by dealers,[1013] the amendments may increase banking entities' profits and the volume of dealer underwriting and market making activity. The SEC notes that the returns and risks arising from banking entity activity may flow through to investors and that investors in securities markets may benefit from market liquidity as it enables exit from investment positions.

Since the 2013 rule requires oversight of internal limits and authorization policies and procedures related to internal limit increases or breaches, this aspect of the final rule is unlikely to result in new compliance burdens for SEC registrants. In addition, the SEC has received comment that some banking entities may already have escalation and recordkeeping procedures when limits are breached or changed.[1014] The SEC continues to believe that agency oversight of internal limits for the purposes of compliance with the final rule may help support the benefits and costs of the substantive prohibitions of section 13 of the BHC Act. The agencies have also received comment that the amendments may allow the agencies to challenge the limit approval and exception process but not the nexus between RENTD and limits.[1015] As discussed above, sections ▮▮.4(c)(1)(i)–(ii) of the final rule require that such limits must be designed not to exceed RENTD.

In the proposal, the SEC noted that some entities may be able to maintain positions that are larger than RENTD and increase risk exposures arising out of trading activities, thus reducing the economic effects of section 13 of the BHC Act and the 2013 rule. The agencies have received comment that limits may be designed to exceed RENTD and banking entities may frequently exceed limits and that introducing the presumption may lead to a deterioration of risk management practices and increase risk taking by banking entity dealers.[1016] However, as discussed above, under the final rule internal limits need to be tied to RENTD, such that if the banking entity complies with the limits it will not maintain positions that are larger than RENTD. The SEC also notes that breaches and changes to internal limits may reflect banking entities' close

[1011] *See, e.g.,* ABA; Credit Suisse; State Street and BB&T.

[1012] *See* JBA.

[1013] *See* section V.F.2.

[1014] *See* JBA.

[1015] *See, e.g.,* Better Markets.

[1016] *See, e.g.,* Volcker Alliance; Better Markets; NAFCU and Public Citizen.

monitoring of market conditions and tailoring such limits, valuable for both internal risk management and supervision and oversight over banking entities. The agencies have received comment that some banking entities may change the way they set internal limits in response to the final rule, for instance, by selecting higher initial limits to avoid breaches or increases for the purposes of section 13 of the BHC Act.[1017] The SEC recognizes these possible effects from entities changing their internal limit setting practices and notes that this effect may reduce the value of closely tailored and dynamically adjusted internal limits for internal oversight and agency supervision. Moreover, the SEC notes that this effect may lead some banking entities to take on greater trading risks. Nevertheless, to satisfy the presumption of compliance, such trading activity must conducted within risk and position limits designed not to exceed RENTD, and thus be consistent with section 13(d)(1)(B) of the BHC Act. The SEC also notes that the final rule contains recordkeeping obligations concerning any exceeded limits or temporary or permanent increases to limits, which may facilitate agency oversight but impose new burdens on banking entities. As discussed in section V.B, this aspect of the final rule may increase initial burdens [1018] by $8,870 [1019] for SEC-registered banking entities and ongoing burdens for SEC-registered broker-dealers by approximately $227,278 per year and for SBSDs by approximately $38,831 per year.[1020]

The final rule also eliminates the requirements of the market making exemption related to the demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors concerning financial instruments in which the trading desk makes a market, including though block trades. Some commenters indicated that this aspect of the amendments gives banking entities greater discretion to establish higher risk and inventory limits in excess of RENTD [1021] and that banking entities should be required to demonstrate the analysis behind their RENTD forecasts and compare ex-ante forecasts with ex-post realizations.[1022] However, the agencies also received comment that RENTD can significantly deviate from historically observed levels, particularly in times of severe market stress, and internal limits designed to not to exceed RENTD may be based on current or forward looking customer inquiries, anticipated volatility shocks, and other forward looking information about market conditions and the evolving risks of a particular desk.[1023] The SEC also notes that, under the final rule, the presumption of compliance requires risk and position limits to be designed not to exceed RENTD and that the agencies may rebut the presumption as discussed above.

Four key aspects of the final rule are aimed at mitigating these risks and costs. First, the internal limits, including any changes to limits, used to establish the presumption of compliance are subject to rebuttal procedures discussed above, and the final rule requires that the internal limits are designed not to exceed RENTD and take into account the liquidity, maturity, and depth of the market for the relevant type of security or financial instrument. Second, the presumption of compliance is conditional on the banking entity's prompt action to bring the trading desk into compliance if a limit is exceeded. Third, banking entities are required to establish and comply with a robust set of internal policies and procedures, requiring review of limits, demonstrable analysis of a basis for any limit increase, and independent review of such analysis and approval. Fourth, the economic effects of the presumption of compliance interact with the effects of the amended trading desk definition, which the SEC believes will allow the agencies to better oversee trading activity across a given banking entity's trading desks and across groups of banking entities to determine whether the internal limits are appropriately designed not to exceed RENTD.

The SEC also notes that the final rule tailors compliance obligations of banking entities for purposes of the exemptions for underwriting and market making-related activities. The economic effects of the final amendments related to compliance are discussed in section V.F.3.g.

The SEC continues to believe that the overall economic effect of these amendments will depend on how banking entities choose to comply with the substantive prohibitions in section 13 of the BHC Act and the 2013 rule as amended. Specifically, banking entities are likely to weigh the unmet demand for and profitability of client facilitation activity against the potential costs of establishing and maintaining appropriate internal limits.[1024] The SEC does not have data on the volume of trading activity that does not occur because of the costs associated with complying with the RENTD requirement or data on the profitability of such trading activity for SEC-regulated banking entities. The SEC is not aware of any such data, and commenters did not provide data enabling such quantification.[1025]

ii. Efficiency, Competition, and Capital Formation

The SEC believes that the final rule may reduce the costs of relying on the exemptions for underwriting and market making-related activities, which may facilitate the activities related to these exemptions. The evolution in market structure in some asset classes (*e.g.,* equities) has transformed the role of traditional dealers vis-à-vis other participants, particularly as it relates to high-frequency trading and electronic platforms. However, dealers continue to play a central role in less liquid markets, such as corporate bond and over-the-counter (OTC) derivatives markets. While it is difficult to establish causality, corporate bond dealers, particularly bank-affiliated dealers, have, on aggregate, significantly reduced their capital commitment post-crisis.[1026] Corporate bond dealers are increasingly shifting from trading in a principal capacity to agency trading. To the extent that this change cannot be explained by enhanced ability of dealers to manage corporate bond inventory, electronic trading, post-crisis changes in dealer risk tolerance and macro factors (effects

[1017] *See, e.g.,* Capital One et al.; Better Markets; and State Street.

[1018] For the purposes of the burden estimates in this release, the SEC is assuming the cost of $423 per hour for an attorney, from SIFMA's ''Management & Professional Earnings in the Securities Industry 2013,'' modified to account for an 1,800-hour work year, multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, and adjusted for inflation as of June 2019.

[1019] Initial reporting and recordkeeping burdens: 0.5 hours × 0.18 dealer weight × [199 broker-dealers + 34 SBSDs not already registered as broker-dealers] × Attorney at $423 per hour = $8,870.

[1020] Ongoing burdens for broker-dealers: [10 hours recordkeeping + 5 hours reporting] × 0.18 dealer weight × 199 × Attorney at $423 per hour = $227,278.

Ongoing burdens for SBSDs: [10 hours recordkeeping + 5 hours reporting] × 0.18 dealer weight × 34 SBSDs not already registered as broker-dealers × Attorney at $423 per hour = $38,831.

[1021] *See* Volcker Alliance.

[1022] *See* Data Boiler.

[1023] *See, e.g.,* FSF.

[1024] *See, e.g.,* 83 FR at 33532.

[1025] The SEC observes that, as shown in Table 1, broker-dealers affected by the final rule have total assets of approximately $3.14 trillion and holdings of approximately $761.53 billion. If the final amendments increase affected broker-dealer holdings by even 0.01%, the economic impact of the final rule may exceed $100 million.

[1026] *See, e.g.,* FRB's ''Staff Q2 2017 Report on Corporate Bond Market Liquidity.'' *See also* section V.F.2 above.

which themselves need not be fully independent of the effect of section 13 of the BHC Act and the 2013 rule), such effects may point to a reduced supply of liquidity by dealers. Moreover, corporate bond dealers decrease liquidity provision in times of stress after the 2013 rule.[1027] In dealer-centric single-name CDS markets, interdealer trade activity, trade sizes, quoting activity, and quoted spreads for illiquid underliers have deteriorated since 2010, but dealer-customer activity and various trading activity metrics have remained stable.[1028]

Because of the methodological challenges described earlier in this analysis, the SEC cannot quantify potential effects of the 2013 rule in general—and the RENTD, underwriting, and market making provisions of the 2013 rule in particular—on capital formation and market liquidity. The SEC also recognizes, as discussed above, that these provisions may not be currently affecting all securities markets, asset classes, and products uniformly. If, because of uncertainty and the costs of relying on exemptions for market making-related activity and risk-mitigating hedging, dealers currently limit their market making and hedging activity in certain products, the final rule may facilitate market making. Because secondary market liquidity can affect the willingness to invest in primary markets, and access to liquidity in these markets can enable market participants to mitigate undesirable risk exposures, the amendments may increase trading activity and capital formation in some segments of the market.

While section 13 of the BHC Act and the 2013 rule, as amended, prohibit banking entities from engaging in proprietary trading, some trading desks may attempt to use certain elements of the final RENTD amendments to circumvent those restrictions, which may reduce the economic effects of the 2013 rule outlined in the economic baseline. However, under the final rule, internal limits and policies and procedures regarding breaches and limit increases and other aspects of banking entities' compliance with section 13 of the BHC Act remain subject to the full scope of agency oversight and supervision, and the presumption of compliance is rebuttable.

The SEC continues to recognize that proprietary trading by banking entities may increase the risk exposures of banking entities, may give rise to economic inefficiency because of implicitly subsidized risk exposures of banking entities, and may increase market fragility and conflicts of interest between banking entities and their customers.[1029] However, the SEC also recognizes the comments and research discussed above concerning the unintended effects of the 2013 rule on valuable underwriting and market making activities, and the nuanced effects of section 13 of the BHC Act and the 2013 rule on the overall volume and structure of banking entity risk exposures.

The SEC continues to believe that, where the final rule increases the scope of permissible activities or decreases the risk of detection of proprietary trading, its effect on informational efficiency stems from a balance of two effects.[1030] On the one hand, where proprietary trading strategies are based on superior analysis and prediction models, their enhanced ability to trade on such information may make securities markets more informationally efficient. While such proprietary trading strategies can be executed by dealers that are not affiliated with banking entities and therefore unaffected by the prohibitions on proprietary trading, their ability to do so may be constrained by their limited access to capital and a lack of scale needed to profit from such strategies. On the other hand, if superior information is obtained by an entity from its customer-facing activities and as a result of conflicts of interest, and if such conflicts are recognized by other market participants, proprietary trading may make other market participants less willing to transact with banks or participate in securities markets, potentially reducing informational efficiency.

iii. Alternatives: Prompt Notice, Thresholds

The agencies could have adopted a prompt notice requirement for limit breaches and limit changes, such as internal limit increases, for all or a subgroup of banking entities. Prompt notification of breaches and changes to internal limits under the alternative may provide more immediate information to agencies about limit breaches and changes supporting oversight.[1031] The agencies have received comment that such prompt notice may be especially beneficial for the oversight of smaller and mid-size banking entities with less sophisticated internal controls that may be more susceptible to risks from rogue trading.[1032]

However, consistent with the views of a number of commenters,[1033] the SEC believes that the prompt notice requirement would have imposed considerable costs on registrants. Such information may duplicate metrics reporting for Group A entities and other information provided to the agencies in the ordinary course of prudential supervision.[1034] Further, such costs would likely be most significant for Group B and Group C entities that do not engage in significant trading activity and which may face more difficulties absorbing reporting costs,[1035] as well as for non-U.S. banking entities with large non-U.S. operations.[1036] In addition, internal limit increases or breaches may reflect changes in market conditions and not changes in a banking entity strategy or risk tolerance, and smaller and mid-size banks may currently be setting internal limits considerably below RENTD.[1037] Finally, to the degree that market participants may interpret the prompt reporting requirement as an enhanced regulatory focus on the number of times an entity has breached RENTD, traders may become less willing to request limit increases to accommodate customer demand; [1038] alternatively, entities may set higher internal limits to avoid breaches or increases.[1039]

The final rule balances these considerations by imposing recordkeeping requirements that enable the agencies to access books and records concerning internal limit increases and breaches in the course of other supervision, inspections, and examinations; require prompt action to bring the trading desk back in compliance in the event of a breach; and impose requirements concerning policies and procedures for escalation, for demonstrable analysis of the basis for internal limit increases, and for independent review for such analysis and approval.

The agencies could have also adopted the internal limit approach, but with more or less flexibility provided to banking entities in setting internal limits. For example, the agencies could have specified that a desk's internal

[1027] *See* section V.F.2. above.

[1028] For a literature review and data, *see* SEC Report 2017, *supra* note 774.

[1029] *See* 83 FR at 33533.

[1030] *See* 83 FR at 33534.

[1031] *See, e.g.,* Data Boiler.

[1032] *See, e.g.,* CFA.

[1033] *See, e.g.,* ABA; Committee on Capital Markets; Credit Suisse; GFMA; FSF; JBA and BB&T.

[1034] *See, e.g.,* FSF; SIFMA; ABA; CREFC; GFMA; Goldman Sachs; Real Estate Associations and ISDA.

[1035] *See, e.g.,* Capital One et al.

[1036] *See, e.g.,* JBA and IIB.

[1037] *See* BOK.

[1038] *See, e.g.,* CCMC.

[1039] *See, e.g.,* Capital One et al.; Better Markets; MBA and State Street.

limits can reflect risk appetite, risk capacity, and business strategy, so long as that desk holds itself out as a market maker; the agencies could have also permitted limits based on absolute value of profit and loss (in the case of an underwriting desk).[1040] The agencies could have also adopted an approach under which the internal limits necessary for the presumption of compliance are developed in collaboration with onsite supervisors or prudential examiners.[1041] The agencies could have also adopted an approach under which all or Group B and Group C banking entities would be able to rely on the presumption of compliance if their internal limits were appropriate to the activities of the desk subject to other existing bank regulations, supervisory review, and oversight by the appropriate agency.[1042] Finally, the agencies could have adopted an approach under which the presumption of compliance is available for activity-based internal limits, such as those based on notional size and inventory turnover.[1043] Alternatives that would provide banking entities with greater flexibility in setting internal limits would bolster the ability of market makers and underwriters to proactively adjust their risk exposures to changing market conditions and potentially accommodate a greater volume of customer demand. At the same time, such alternatives may also allow banking entities to engage in a greater degree of trading activity while relying on the presumption of compliance.

Similarly, one commenter suggested an approach that more prescriptively specifies how banking entities should set and adjust internal limits and what factors they should consider.[1044] Another commenter stated that such a one-size-fits all approach ignores differences in the business models of banking entities and desks.[1045] The SEC believes that, while this alternative may decrease the trading activity of banking entities, it would not appropriately tailor the 2013 rule to the differences in organization, operation, and risks of various banking entities and their trading desks; may hamper client facilitation activity when market conditions are in flux; and may have the unintended effect of banking entities delegating certain risk management functions to the agencies. As discussed above, the final rule specifies that internal limits must be designed not to exceed RENTD and that internal limits of banking entities are subject to ongoing regulatory oversight by the agencies.

The agencies could have adopted an approach under which underwriting and market making requirements are tailored to banking entities on the basis of different thresholds. For example, the agencies could have instead relied on the trading assets and liabilities threshold for market making compliance (as in the final rule), but applied a different threshold for underwriting compliance, such as on the basis of the volume or profitability of past underwriting activity. This alternative would have tailored the compliance requirements for SEC-regulated banking entities with respect to underwriting activities. However, the volume and profitability of underwriting activity is highly cyclical and is likely to decline in weak macroeconomic conditions. As a result, under the alternative, SEC-regulated banking entities would face lower limits with respect to underwriting activity during times of economic stress when covered trading activity related to underwriting may pose the highest risk of loss. The alternative may also limit banking entities in their ability to engage in underwriting during economic weakness when economic activity and capital formation are in decline.

One commenter suggested that the agencies interpret the underwriting exemption broadly to accommodate any activity that assists persons or entities in accessing the capital markets or raising capital, as well as any activities done in connection with a capital raise.[1046] Under such an approach, an underwriter's hedging of unsold, contingent, or forward underwriting allotments would be permissible under the underwriting exemption. To the degree that banking entities are unable to engage in such activities in reliance on the hedging or other exemptions under the 2013 rule, this alternative may increase the ability of some banking entities to hedge some of the risks related to underwriting and their willingness to engage in underwriting activity. Moreover, a broad underwriting exemption would eliminate the need to categorize the underwritten instruments, which may be difficult to do in some foreign markets with respect to loans, repos, securities loans, financial instruments, or derivatives. At the same time, the SEC believes that banking entities may currently be able to engage in hedging related to underwriting activity under the rule, such as in reliance on the hedging exemption.

d. Permitted Risk-Mitigating Hedging

i. Costs and Benefits

As discussed in the proposal,[1047] hedging is an essential tool for risk mitigation and can enhance a banking entity's provision of client-facing services, such as market making and underwriting, as well as facilitate financial stability. In recognition of the important role that this activity can play as part of a banking entity's overall operations, the agencies are adopting a number of changes that streamline and clarify the 2013 rule's exemption for risk-mitigating hedging activities to reduce unnecessary compliance burdens and uncertainty some banking entities face concerning their ability to rely on the hedging exemption.

First, the final rule simplifies the requirements of the risk-mitigating hedging exemption for banking entities that do not have significant trading assets and liabilities. The amendment removes the requirement to have a specific risk-mitigating hedging compliance program, as well as the documentation requirements and certain hedging activity requirements for such entities. As a result, these banking entities are subject to the following requirements: (1) The hedging activity, at the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and (2) the hedging activity is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies these requirements and is not prohibited proprietary trading.

As discussed in the proposal,[1048] banking entities without significant trading assets and liabilities may be less likely to engage in large or complicated trading activities and hedging strategies. The agencies have received comment supporting such reduced compliance

[1040] *See* JBA.

[1041] *See, e.g.,* FSF and SIFMA.

[1042] *See* Capital One et al.

[1043] *See* BB&T.

[1044] *See* Better Markets.

[1045] *See* Committee on Capital Markets.

[1046] *See, e.g.,* ISDA.

[1047] *See, e.g.,* 83 FR at 33535.

[1048] *See, e.g.,* 83 FR at 33536.

requirements for banking entities that do not have significant trading assets and liabilities.[1049] One commenter stated that reduced compliance requirements for risk-mitigating hedging by Group B and Group C banking entities would not affect the safety and soundness of banking entities or financial stability and pointed to the importance of robust monitoring and banking entity risk management in the context of risk-mitigating hedging.[1050] Another commenter opposed this aspect of the amendments and stated that, absent proprietary trading intent, ensuring that hedging does not increase banking entities' risks at inception of the hedge and that trading personnel are not compensated for doing so is not complex.[1051]

The SEC continues to believe that compliance with the 2013 rule, including compliance with the requirements of § ▮▮.5(b)(2), imposes disproportionate costs on banking entities without significant trading assets and liabilities.[1052] The SEC continues to note that, as quantified in the economic baseline, Group B and Group C broker-dealers represent a very small fraction of total assets and holdings in the broker-dealer industry. In addition, fixed compliance costs represent disproportionately greater burdens for smaller entities as they may face greater difficulty absorbing such costs into revenue. Importantly, the final rule does not waive the substantive proprietary trading prohibitions in section 13 of the BHC Act for any banking entity, including for any Group B or Group C banking entity. Instead, the SEC continues to believe that the amendment reduces the costs of relying on the hedging exemption and, thus, the costs of engaging in hedging activities for Group B and Group C entities. To the extent that the removal of these requirements may reduce the costs of risk-mitigating hedging activity, Group B and Group C entities may increase their intermediation activity while also growing their trading assets and liabilities.

Second, the final rule reduces documentation requirements for Group A entities. In particular, the final rule removes the documentation requirements for some risk-mitigating hedging activity. More specifically, the activity is not subject to the documentation requirement if (1) the financial instrument used for hedging is identified on a written list of pre-approved financial instruments commonly used by the trading desk for the specific type of hedging activity; and (2) at the time the financial instrument is purchased or sold the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks.

The agencies received comment that this and other final amendments to the risk-mitigating hedging exemption may lead banking entities to engage in less planning, documentation, and testing in their hedging activities, may reduce the effectiveness of agency oversight, and may weaken the proprietary trading prohibitions of the 2013 rule.[1053] Other commenters supported the revisions, but stated that enhanced documentation requirements for the hedging exemption, as a whole, are unnecessary given the robust compliance framework under the 2013 rule and amendments, and supported the complete elimination of the documentation requirements for all banking entities.[1054]

Consistent with the views of some commenters,[1055] the economic effects with respect to internal limits for the purposes of hedging with pre-approved instruments may be similar to the effects of internal limits for the purposes the underwriting and market making exemptions discussed above. The SEC recognizes that the economic effects of this aspect of the final rule depend on the prevalence of hedging activities in each registrant, their organizational structure, business model, and complexity of risk exposures. However, the SEC continues to believe that the flexibility to choose between providing documentation regarding risk-mitigating hedging transactions and establishing hedging limits for pre-approved instruments may be beneficial for Group A entities, as it will allow these entities to tailor their compliance programs to their specific organizational structure and existing policies and procedures.[1056] At the same time, the SEC believes that the remaining documentation requirements for Group A entities being adopted will facilitate effective internal risk management and agency oversight.

Third, the final rule eliminates the requirement that the risk-mitigating hedging activity must demonstrably reduce or otherwise significantly mitigate one or more specific identifiable risks at the inception of the hedge. Additionally, the demonstrability requirement is also removed from the requirement to continually review, monitor, and manage the banking entity's existing hedging activity. Banking entities will continue to be subject to the requirement that the risk-mitigating hedging activity be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, as well as to the requirement that the hedging activity be subject to continuing review, monitoring and management by the banking entity to confirm that such activity is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging.

Consistent with the views of a number of commenters,[1057] the SEC believes that the removal of the demonstrability requirement may benefit banking entity dealers, as it decreases uncertainty about the ability to rely on the risk-mitigating hedging exemption and may reduce the compliance costs of engaging in permitted hedging activities. The SEC continues to recognize that some SEC-regulated banking entities may respond to this aspect of the final rule by accumulating positions that increase the banking entity's risk exposure through adjustments (or lack thereof) to otherwise permissible hedging portfolios.[1058] The SEC also recognizes concerns raised by commenters that some banking entities may forecast changes in correlations and construct hedging portfolios such that they leave the entity exposed to directional market movements.[1059] The SEC continues to recognize that this may result in increased risks from the trading activity of some banking entities.[1060] However, the final rule's requirement concerning ongoing recalibration may mitigate these adverse effects. In addition, as discussed in greater detail in the economic baseline, the SEC recognizes that trading activity is only one form of activity conducted by banking entities that can increase risk exposure, and that market, credit, and liquidity risks of the banking book as well as the degree to which banking book risks are hedged by tradeable assets all contribute to the overall risk of a banking entity or group of banking entities. As a result, the SEC

[1049] *See, e.g.,* Credit Suisse and BB&T.
[1050] *See* BB&T.
[1051] *See* Better Markets.
[1052] *See, e.g.,* 83 FR at 33536.
[1053] *See, e.g.,* Better Markets; Data Boiler and Bean.
[1054] *See, e.g.,* ABA; FSF; CREFC; BPI and SIFMA.
[1055] *See, e.g.,* Credit Suisse.
[1056] *See, e.g.,* 83 FR at 33536.
[1057] *See, e.g.,* ABA; Credit Suisse and SIFMA.
[1058] *See* 83 FR at 33535. *See also, e.g.,* Better Markets; Bean; Data Boiler and CFA.
[1059] *See, e.g.,* Public Citizen.
[1060] *See, e.g.,* 83 FR at 33536.

recognizes that, to the degree that some banking entities may respond to the final rule by increasing risk exposures arising out of trading activity, these effects may be partly offset by changes in the risks these banking entities take in the normal course of their banking activity or more complete hedging of their banking and trading risks through trading portfolios. Moreover, the SEC believes that this aspect of the final rules may not only benefit banking entities by alleviating compliance burdens related to risk management, but may also benefit clients and counterparties by enabling greater trading activity and liquidity provision by dealers that are banking entities. Furthermore, the SEC reiterates that the returns and risks arising from the activity of banking entities may flow through to banking entity's investors and that investors in securities markets may benefit from greater liquidity as it enables exit from investment positions.

Finally, the final rule removes the requirement to perform the correlation analysis. The SEC continues to recognize that a correlation analysis based on returns may be prohibitively complex for some asset classes and that a correlation coefficient may not always serve as a meaningful or predictive risk metric.[1061] The agencies received comment that permitting additional time to provide correlation analysis would better address time-related challenges; [1062] that requiring statistical tests of randomness to the observed returns on the hedged positions may serve to duly constrain hedging; [1063] and that there should be no regulation-related delays when hedging if banking entities rely on documented and stable risk relationships.[1064] The SEC notes that time costs are only one of the issues in the correlation requirement and that banking entities may not be able to rely on documented and stable risk relationships in quickly evolving market conditions. Although in some instances correlation analysis of past returns may be helpful in evaluating whether a hedging transaction was effective in offsetting the risks intended to be mitigated, the SEC continues to recognize that correlation analysis may not be an effective tool for such evaluation in other instances. For example, correlations across assets and asset classes evolve over time and may exhibit jumps at times of idiosyncratic or systematic stress. In such circumstances, historical correlations among the returns on assets or asset classes may not be representative of the way in which they will affect portfolio risk going forward. Moreover, the SEC notes that asset return correlations may not be informative when financial instruments are traded infrequently, if the prices used to construct asset returns are non-binding indicative quotes (and not actual execution prices). Additionally, the hedging activity, even if properly designed to reduce risk, may not be practicable if costly delays or compliance complexities result from a requirement to undertake a correlation analysis.[1065] These costs and delays may be most acute in times of market stress and during spikes in volatility, during which customers and other dealers may demand greater liquidity. The SEC continues to believe that the removal of the correlation analysis requirement may provide dealers with greater flexibility in selecting and executing risk-mitigating hedging activities.[1066]

The SEC received comments that the elimination of the correlation analysis may impede supervisory review, enable some banking entities to disguise proprietary trades as hedges, or result in permissible over- or under-hedging due to changes in asset correlations over time.[1067] Other commenters indicated that correlation analysis is highly automated and forces banking entities to be more purposeful in hedging activities.[1068] The SEC recognizes these concerns and continues to recognize that the removal of the correlation analysis requirement involves the tensions of the effects discussed above.[1069] The SEC continues to recognize that, to the extent that some banking entities may respond to this aspect of the final rule by engaging in more trading activities that leave them exposed to directional market movements while relying on the risk-mitigating hedging exemption, this aspect of the final rule may increase risk taking and conflicts of interest between banking entities and their customers. However, the SEC believes that the final rule's requirement concerning ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements above and is not prohibited proprietary trading may mitigate these concerns. In addition, similar to the discussion above, the SEC continues to recognize that changes in the overall risk of banking entities reflect both changes in the risk of trading activities and their banking activities. Importantly, the SEC continues to believe that the requirement to engage in correlation analysis may have slowed the timing of hedging activities by some banking entities and may not be beneficial for prudent risk management or practical under some circumstances. Moreover, the SEC continues to believe that potential increases in permitted risk-mitigating hedging may benefit clients, customers, and counterparties by increasing trading activity and capital formation by banking entities, particularly in times of market stress and during spikes in volatility. Finally, under the final rule, banking entities remain subject to the full scope of agency oversight over trading activities in reliance on the hedging exemption.

As discussed above, the SEC estimates burden reductions, per firm, as a result of the final rule. The final amendments to § ■■.5(c) may result in ongoing cost savings for SEC-registered broker-dealers [1070] estimated at $1,295,903.[1071] Additionally, the final rule will result in lower ongoing costs for potential SBSD registrants relative to the costs that they would incur under the 2013 rule's regime if they were to choose to register with the SEC—this cost reduction is estimated to reach up to $51,775.[1072] However, the SEC recognizes that compliance with SBSD registration

[1061] *See* 83 FR at 33535. *See also, e.g.,* ABA; Credit Suisse; JBA; SIFMA and CREFC.

[1062] *See, e.g.,* Better Markets.

[1063] *Id.*

[1064] *Id.*

[1065] *See, e.g.,* SIFMA.

[1066] *See, e.g.,* 83 FR at 33535.

[1067] *See, e.g.,* AFR; Bean; NAFCU; Public Citizen; Volcker Alliance; Better Markets and Systemic Risk Council.

[1068] *See, e.g.,* AFR and Data Boiler.

[1069] *See* 83 FR at 33536.

[1070] The SEC continues to believe that the burden reduction for SEC-regulated entities will be a fraction of the burden reduction for the holding company as a whole. In the proposal, the SEC attributed 18% of the reductions in holding company (parent) burdens to the dealer affiliates, on the basis of the average weight of broker-dealer assets in holding company assets. The SEC received no comment on this estimate and continues to rely on this figure in estimates of compliance burden reductions for SEC registrants. However, the SEC recognizes that compliance burdens may be borne disproportionately by dealer affiliates because of their role in trading for the holding company. As a result, some dealers may currently be bearing a larger fraction of holding company compliance burdens related to section 13 of the BHC Act. To this extent, the estimates of compliance burden savings may underestimate the magnitude of the benefits enjoyed by SEC registrants under the final amendments.

[1071] Ongoing recordkeeping burden reduction for broker-dealers: (100 hours per firm × 0.18 weight × (Attorney at $423 per hour) × 199 firms)¥(80 hours per firm × 0.18 weight × (Attorney at $423 per hour) × 36 firms affiliated with Group A entities) = $1,515,186¥$219,283 = $1,295,903.

[1072] Recordkeeping burden reduction for entities that may register as SBSDs: (100–80) hours per firm × 0.18 weight × (Attorney at $423 per hour) × 34 SBSDs not already registered as broker-dealers = $51,775. This estimate assumes all SBSDs are Group A entities and will still be subject to these ongoing recordkeeping obligations.

requirements is not yet required and that there are currently no registered SBSDs.

ii. Efficiency, Competition, and Capital Formation

The primary efficiency, competition, and capital formation effects of the risk-mitigating hedging amendments stem from competition and capital formation. The final hedging amendments provide greater relief with respect to the requirements of the exemption for hedging activity to Group B and Group C entities relative to Group A entities. Since the fixed costs of relying on such exemptions may be more significant for entities with smaller trading books, the final hedging amendments may permit Group B entities just below the $20 billion threshold to more effectively compete with Group A entities just above the threshold.

The final hedging amendments may also influence the volume of hedging activity and capital formation. To the extent that some registrants currently experience significant compliance costs related to the hedging exemption, these costs may constrain the amount of risk-mitigating hedging they currently engage in. The ability to hedge underlying risks at a low cost can facilitate the willingness of SEC-regulated entities to commit capital and take on underlying risk exposures. Because the final rule may reduce costs of relying on the hedging exemption, these entities may become more incentivized to engage in risk-mitigating hedging activity, which may in turn contribute to greater capital formation.

These amendments to risk-mitigating hedging do not change the amount or type of information available to market participants, and the SEC does not believe that the final rule is likely to have an effect on informational efficiency. To the degree that these amendments may enable some banking entities to more easily rely on the hedging exemption, and to the extent that hedging supports extension of credit and other capital formation, these amendments may somewhat improve allocative efficiency.

iii. Alternatives

The agencies could have adopted an approach that would exclude from the proprietary trading prohibition or allow all or a subset of banking entities (such as Group B and Group C entities) to rely on the presumption of compliance with respect to hedging activity accounted for under hedge accounting principles.[1073] The agencies could have also adopted an approach excluding trading activity of non-U.S. banking entities accounted for under hedge accounting rules in their home jurisdictions.[1074] The SEC believes that such alternatives would effectively replace the compliance and documentation obligations for permitted risk-mitigating hedging in the 2013 rule as amended in this final rule with the compliance obligations necessary for an entity to qualify for hedge accounting treatment. For example, banking entities must generally document the hedge relationship, including hedge objectives, risks being hedged, hedged item and the financial instrument used in the hedge, demonstrate that the hedge is highly effective, and recognize any ineffectiveness in profits and losses.[1075] As a result, some commenters [1076] indicated that such approaches may reduce compliance duplication and further reduce uncertainty regarding the ability of some banking entities to rely on the risk-mitigating hedging exemption with respect to certain hedging transactions.

However, the SEC also recognizes commenter concerns that the compliance and effectiveness testing for the purposes of hedge accounting are designed for the purposes of transparent and informative financial statements and are not designed to distinguish between prohibited proprietary trading and permissible risk-mitigating hedging for the purposes of section 13 of the BHC Act.[1077] Moreover, international accounting standards may not involve the same level of compliance, documentation, and effectiveness testing as either the U.S. hedge accounting standards or the compliance program for the hedging exemption of the 2013 rule. As a result, the SEC continues to believe that the final rule implements the purposes of section 13 of the BHC Act while reducing compliance burdens on most affected registrants.

As another alternative, the agencies could have adopted an approach, under which compliance with the risk-mitigating hedging exemption is applied on the basis of analysis of the trading desk's activities as a whole and not on a trade-by-trade basis.[1078] In a related vein, the agencies could have adopted an approach that allows portfolio hedging that is not contemporaneous with the inception of the position being hedged and that does not occur at the desk to which the risk is booked, so long as the hedging exposure remains within permitted internal limits applicable to each desk and to the banking entity as a whole.[1079] The SEC believes that such alternatives would have the effect of enabling firm-wide macro hedges of a banking entity's risk exposures by centralized risk management desks, which may involve fewer transaction costs and reduce the burden of demonstrating compliance with the hedging exemption for each trade. However, such an approach may make it more difficult for the agencies and banking entities to oversee compliance with the hedging exemption and distinguish between transactions reasonably designed at their inception to hedge specific risks and impermissible proprietary trades intended to profit from asset mispricing or directional changes in the value of assets or asset classes.

As discussed above, the agencies could have also eliminated all enhanced documentation requirements for Group A banking entities and all other conditions of the hedging exemption not expressly required by the statute.[1080] The SEC believes that, relative to the final rule, such an alternative would further reduce compliance burdens on Group A banking entities and uncertainty regarding their ability to rely on the hedging exemption and may increase the volume of risk-mitigating hedging by Group A banking entities. However, the elimination of enhanced documentation requirements as a whole and other conditions of the exemption may also reduce the effectiveness of internal risk management and agency oversight of Group A entities and may result in increased trading activity by Group A entities in reliance on the hedging exemption. This risk may be particularly acute given the size and complexity of trading activity of Group A entities and their role in the dealer industry and in the U.S. financial system as a whole.

The agencies could have adopted an explicit exclusion from the proprietary trading prohibition for hedges of corporate debt issuances. Specifically, the agencies have received comment that financial institutions may routinely hedge debt securities issued for corporate purposes with interest rate swaps, which fall into the trading account under the 60-day rebuttable

[1073] *See, e.g.,* Capital One et al., JBA, ABA and KeyCorp.

[1074] *See* JBA.

[1075] *See* FASB, Derivatives and Hedging (Topic 815) (Aug. 2017). *See also* International Financial Reporting Standard ("IFRS") 9 (Financial Instruments). *See also* Capital One et al.

[1076] *See* Capital One et al. and JBA.

[1077] *See, e.g.,* Data Boiler.

[1078] *See, e.g.,* Credit Suisse and CCMC.

[1079] *Id.*

[1080] *See, e.g.,* ABA; FSF; CREFC; BPI and SIFMA.

presumption of the 2013 rule.[1081] As discussed above, the final rule modifies the short-term prong of the trading account definition, reducing the likelihood that such activity would fall in to the trading account and require the reliance on the hedging exemption. As a result, the SEC believes that the final rule may enable valuable and routine hedging of corporate debt issued by banking entities subject to the short-term prong without the costs of complying with the risk-mitigating hedging exemption.

e. Exemption for Foreign Trading

i. Costs and Benefits

Foreign banking entities seeking to rely on the exemption for trading outside of the United States under the 2013 rule face a complex set of compliance requirements that may result in significant burdens and implementation inefficiencies, which may have reduced cross-border trading activity and liquidity between U.S. and non-U.S. entities.[1082] In particular, agencies have received comment from some market participants that compliance with the financing prong may be difficult for some non-U.S. banking entities because of the fungibility of some forms of financing.[1083] In addition, the SEC continues to recognize that satisfying the U.S counterparty prong is burdensome for foreign banking entities and may have led some foreign banking entities to reduce the range of counterparties with which they engage in trading activity.[1084] The final rule removes the financing and counterparty prongs.

Under the final rule, financing for a transaction relying on the foreign trading exemption can be provided by U.S. branches or affiliates of foreign banking entities, including U.S. branches or affiliates that are SEC-registered dealers. Foreign banking entities may benefit from the final rule because of the greater flexibility afforded to how they are permitted to finance their transaction activity in reliance on the foreign trading exemption. The agencies have also received comment supporting the focus of the exemption on the location of the principal risk and the location in which decision making behind the trading occurs.[1085] At the same time, the agencies have received comment that the proposed amendments to the exemption may increase the vulnerability of the U.S. financial system to proprietary trading losses of foreign banking entities.[1086] However, for the reasons noted below, the SEC does not believe that the amendments will, on balance, increase vulnerability in the manner described by commenters. Specifically, the SEC continues to recognize that some of the economic exposure and risks of proprietary trading by foreign banking entities may flow not just to the foreign banking entities, but to U.S.-located entities financing the transactions, *e.g.,* through margin loans.[1087] However, potential adverse effects on vulnerability may be mitigated by two primary factors. First, the SEC notes that the final rule retains the condition that any purchases or sales by a foreign banking entity, including any hedging trades, are not accounted for as principal directly or on a consolidated basis by any U.S. branch or affiliate of the foreign banking entity. Thus, under the final rule, the principal risk of proprietary trading by non-U.S. banking entities will remain outside of the United States. Moreover, U.S. banking entities providing financing to their foreign banking entity affiliates are likely to be separately subject to a full range of capital, margin, and other obligations unrelated to section 13 of the BHC Act, which may reduce risks to the U.S. branches and affiliates of foreign banking entities. The SEC believes that the focus on where the principal risk and decision making behind the trading resides tailors the application of the 2013 rule with respect to foreign banks' non-U.S. operations by reducing compliance burdens and uncertainties of foreign banking entities in their trading activity.[1088]

In addition, the final rule removes the counterparty prong and its corresponding clearing and anonymous exchange and personnel requirements. As a result, the final rule makes it easier for foreign banking entities to transact with or through U.S. counterparties. To the extent that foreign banking entities are currently bearing [1089] and passing along compliance burdens to their U.S. counterparties, or are unwilling to intermediate or engage in certain transactions with or through U.S. counterparties, the final rule may reduce transaction costs for U.S. counterparties and may increase the volume of trading activity between U.S. counterparties and foreign banking entities.[1090]

The SEC recognizes that this aspect of the final rule may adversely affect the current competitive standing of U.S. banking entities insofar as foreign banking entities will have greater ability to engage in proprietary trading activities with U.S. counterparties.[1091] However, the removal of the counterparty prong in the final rule maintains a comparable treatment of the U.S. operations of U.S. and non-U.S. banking entities with respect to the transactions that are booked in the U.S., as neither U.S. nor non-U.S. banking entities are able to rely on the foreign trading exemption for such activity.[1092] The agencies have also received comment that the elimination of clearing and exchange requirements may enable U.S. intermediaries to compete for business in OTC financial products with foreign banking entity counterparties, and that the amendments may foster trading activity between foreign affiliates and branches of U.S. banking entities and foreign banking entities without the constraints under the counterparty prong on the involvement of their U.S. personnel.[1093]

When a foreign banking entity engages in proprietary trading through a U.S. dealer, such trades expose the counterparty to risks related to the transaction, though such risks born by U.S. counterparties likely depend on both the identity of the counterparty and the nature of the instrument and terms of trading position. Moreover, the SEC continues to emphasize that concerns about moral hazard and the volume of risk-taking by foreign banking entities may be less relevant for U.S. markets for two reasons.[1094] First, foreign banking entities are less likely to be beneficiaries of U.S. deposit insurance and implicit bailout guarantees. Second, foreign banking entities are likely subject to foreign

[1081] *See* KeyCorp.

[1082] *See, e.g.,* JBA; HSBC; ABA; ISDA; Credit Suisse; Committee on Capital Markets and IIB.

[1083] *See, e.g.,* EBF (citing 83 FR at 33468–69).

[1084] *See, e.g.,* 83 FR at 33537.

[1085] *See, e.g.,* ABA; ISDA; Credit Suisse; Committee on Capital Markets and IIB.

[1086] *See, e.g.,* Bean; NAFCU; Better Markets; Merkley and Data Boiler.

[1087] *Id.*

[1088] In addition, the agencies confirmed in this SUPPLEMENTARY INFORMATION that the foreign trading 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. To the extent that foreign banking entities were restricting engagement of non-affiliated U.S. investment advisers due to uncertainty about the 2013 rule, non-affiliated U.S. investment advisers may become better able to compete for the foreign banking entity's investment mandates.

[1089] *See, e.g.,* HSBC.

[1090] *See, e.g.,* JBA.

[1091] *See, e.g.,* FSF.

[1092] *See, e.g.,* IIB.

[1093] *Id.*

[1094] *See, e.g.,* 83 FR at 33537. *See also* JBA.

securities and prudential regulations that address these concerns.

In addition, as proposed, the final rule replaces references to personnel arranging, negotiating, and executing trades with references to relevant personnel. This change is consistent with the views of some commenters, who stated that the current arrange, negotiate, or execute test is burdensome and may restrain trading activity outside of the U.S.[1095] Specifically, the availability of the foreign trading exemption is amended to be conditioned on the banking entity engaging as a principal (including relevant personnel) not being located in the U.S. or organized under U.S. laws. As discussed elsewhere in this **SUPPLEMENTARY INFORMATION**, the agencies are modifying the rule such that relevant personnel for the purposes of the foreign trading exemption are limited to personnel engaged in the banking entity's decision in the purchase or sale as principal. The SEC believes that the location of the personnel engaged in the banking entity's decision in the purchase or sale is a meaningful trigger for the application of section 13 of the BHC Act and implementing rules. Specifically, the SEC has considered how narrowing the personnel requirement may increase risk exposure of banking entities from trading activity and conflicts of interest between banking entities and their clients on the one hand and may enhance market quality and availability of trading counterparties on the other hand. In addition, as part of the baseline for analysis, the conditions for the foreign trading exemption in the 2013 rule include both requirements concerning relevant personnel that makes the decision to purchase or sell as principal and requirements concerning personnel involved in arranging, negotiating, and executing trades. As a result, under the 2013 rule foreign banking entities have to determine whether a particular employee meets both the requirements related to relevant personnel and related to personnel arranging, negotiating, and executing purchases and sales. This aspect of the final rule eliminates the need for a foreign banking entity to separately establish that a given employee meets both sets of requirements, reducing inefficiencies associated with foreign banking entities relying on the foreign trading exemption from the proprietary trading prohibition.

[1095] *See, e.g.,* EBF; HSBC and IIB.

ii. Efficiency, Competition, and Capital Formation

The final rule likely expands the scope of trading activity by foreign banking entities that may qualify for the foreign trading exemption. As a result, the amendments may reduce the costs, benefits, and effects on efficiency and capital formation of the 2013 rule discussed in the economic baseline, and may increase competition between U.S. and foreign banking entities. The final rule reflects consideration of the potentially inefficient restructuring of activities undertaken by foreign banking entities after the 2013 rule came into effect and the loss of access of U.S. market participants to foreign banking entity counterparties, on the one hand,[1096] and, advancement of the objectives of section 13 of the BHC Act, on the other hand.

Allowing foreign banking entities to be financed by U.S.-dealer affiliates and to transact with U.S. counterparties on an OTC basis (*i.e.,* off-exchange) and without clearing the trades, may reduce costs of non-U.S. banking entities' trading activity under the foreign trading exemption, including with U.S. counterparties. These costs may currently represent barriers to entry for foreign banking entities that contemplate engaging in trading and other transaction activity using a U.S. affiliate's financing and OTC trading with U.S. counterparties. To that extent, the final rule may provide (1) incentives for foreign banking entities that currently receive financing from non-U.S. affiliates or other sources to move financing to U.S. dealer affiliates, and (2) incentives for foreign banking entities that currently do not transact with or through U.S. counterparties (or transact with or through U.S. counterparties only in transactions that are promptly cleared) to transact with or through U.S. counterparties (or transact with or through U.S. counterparties outside of promptly cleared transactions). As a result, the number of banking entities engaging in trading activities in U.S. markets may increase, which may enhance the incorporation of new information into prices. However, the amendments may result in a shift in securities trading activity away from U.S. banking entities to foreign banking entities that are not comparably regulated.

[1096] In the Proposing Release, the SEC noted that, according to one market participant, at least seven international banks have terminated or transferred existing transactions with U.S. counterparties in order to comply with the foreign trading exemption and to avoid compliance costs of relying on alternative exemptions or exclusions. *See* 83 FR at 33537.

The final rule may increase market entry, as it will decrease the need for foreign banking entities to rely on a narrower set of unaffiliated market intermediaries in order to conduct trading activity under the foreign trading exemption in compliance with the 2013 rule. Additionally, the final rule may increase operational efficiency of trading activity by foreign banking entities in the United States, which may decrease costs to market participants and may increase the level of market participation by U.S-dealer affiliates of foreign banking entities.

Consistent with the views of commenters,[1097] the SEC continues to recognize that the final rule may also affect competition among banking entities.[1098] The statute may introduce competitive disparities between U.S. and foreign banking entities. Under the final rule, foreign banking entities may enjoy a greater degree of flexibility in financing proprietary trading and transacting with or through U.S. counterparties relative to the baseline. At the same time, U.S. banking entities are not able to engage in proprietary trading and are subject to the substantive prohibitions of section 13 of the BHC Act. One commenter indicated that non-U.S. banking entities will continue to bear operational burdens because of the legal entity requirements.[1099] To the degree that the final requirements regarding the location of the principal risk and relevant personnel are still burdensome and constraining foreign banking entities in their reliance on the foreign trading exemption, this may partly dampen the above competitive effect. To the extent that banking entities at the holding company level may be able to reorganize and move their business to a foreign jurisdiction, some U.S. banking entity holding companies may exit from the U.S. regulatory regime. However, under sections 4(c)(9) and 4(c)(13) of the Banking Act, U.S. entities would have to conduct the majority of their business outside of the United States to become eligible for the exemption, reducing potential effects of their activities on U.S. markets. In addition, certain changes in control of banks and bank holding companies require supervisory approval. Hence, the feasibility and magnitude of such regulatory arbitrage remain unclear. The SEC also notes that, as referenced above, the final rule preserves equal competitive treatment of the U.S. operations of both U.S. and

[1097] *See, e.g.,* Bean; Data Boiler; FSF and Better Markets.

[1098] *See* 83 FR at 33538.

[1099] *See, e.g.,* JBA.

non-U.S. banking entities that will remain unable to rely on the foreign trading exemption and will remain subject to section 13 of the BHC Act.[1100]

To the extent that foreign banking entities currently engage in cleared transactions with or through U.S. counterparties because of the existing counterparty prong but would have chosen not to do so otherwise, the final rule may reduce the amount of cleared transactions. This may reduce opportunities for risk-sharing among market participants and increase idiosyncratic counterparty risk born by U.S. and foreign counterparties.

At the same time, the final rule may increase the availability of liquidity and reduce transaction costs for market participants seeking to trade in U.S. securities markets. To the extent that non-U.S. banking entities will face lower costs of transacting with U.S. counterparties, it may become easier for U.S. banking entities or customers to find a transaction counterparty willing to engage in, for instance, hedging transactions. To that extent, U.S. market participants accessing securities markets to hedge financial and commercial risks may increase their hedging activity and assume a more efficient amount of risk. The potential consequences of relocation of non-U.S. banking entity activity to the United States for liquidity and risk-sharing may be most concentrated in those asset classes and market segments where activity is most constrained by the requirements in the 2013 rule.

iii. Alternatives

The agencies could have amended the foreign trading exemption to remove all conditions for the exemption, including the engaging as principal and decision-making requirements, except for the booking requirement.[1101] Relative to the final rule, the SEC believes that such an alternative approach would further lower the compliance burdens of non-U.S. banking entities relying on the foreign trading exemption and may foster more trading activity by U.S. affiliates of non-U.S. banking entities. For example, the agencies have received comment that the engaging as principal and decision-making requirements have led Japanese firms to downsize their U.S. affiliates and that the decision-making requirement is operationally difficult for Japanese banks executing trades in U.S. markets because of time zone differences.[1102] To the degree that this alternative encourages more activity of non-U.S. banking entities in the United States, U.S. counterparties may benefit from greater availability and choice of banking entity counterparties. However, the alternative would place U.S. banking entities at a greater competitive disadvantage relative to the final rule, because it would result in more flexibility for the U.S. operations of non-U.S. banking entities to engage in trading activities relative to the U.S. operations of U.S. banking entities.

In addition, the agencies have received comment suggesting an exclusion of non-U.S. banking entities with limited U.S. assets and operations from the scope of section 13 of the BHC Act.[1103] The SEC notes that nothing in the final rule changes or waives ongoing statutory obligations of banking entities. However, to the degree that reliance on the foreign trading exemption is burdensome and prevents non-U.S. entities from trading in the United States, the final rule may reduce compliance burdens related to the 2013 rule by introducing the presumption of compliance for Group C banking entities. As discussed above, the Group C threshold of $1 billion applies to the trading assets and liabilities of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States). As a result, under the final rule, non-U.S. banking entities that have limited trading assets and liabilities in the United States will be able to avail themselves of the rebuttable presumption of compliance and will no longer be required to bear the fixed costs and burdens of demonstrating compliance with section 13 of the BHC Act and the 2013 rule.

f. Covered Funds

The agencies are adopting amendments to § ▮▮.11 and § ▮▮.13, as proposed.

i. Costs and Benefits

First, the final rule removes the requirement in § ▮▮.11(c)(3) of the 2013 rule that a banking entity include, for purposes of the aggregate fund limit and capital deduction, the value of any ownership interests of a third-party covered fund (*i.e.,* a covered fund that the banking entity does not advise or organize and offer pursuant to § ▮▮.11 of the 2013 rule) acquired or retained in accordance with the underwriting or market making exemptions in § ▮▮.4. In addition, the final rule removes the guarantee language in § ▮▮.11(c)(2) of the 2013 rule which requires a banking entity to include, for purposes of the aggregate fund limit and capital deduction, the value of any ownership interests of a covered fund, the obligations or performance of which is directly or indirectly guaranteed, assumed, or insured by the banking entity.

The final amendments aim to more closely align the requirements for engaging in underwriting or market making-related activities with respect to ownership interests in covered funds with the requirements for engaging in these activities with respect to other financial instruments. The SEC agrees with a number of commenters [1104] and continues to believe that the 2013 rule imposed requirements on dealers' transactions in ownership interests in covered funds that may limit the ability of dealers to underwrite and make markets in ownership interests in covered funds, even if dealers are able to underwrite and make markets in the underlying securities owned by covered funds or in securities that are otherwise similar to ownership interests in covered funds. The SEC continues to believe that, as also articulated by a number of commenters,[1105] the final amendments provide banking entities with greater flexibility in underwriting and market making ownership interests in covered funds.

In addition, the SEC continues to recognize that the 2013 rule's restrictions on underwriting and market making-related activities involving ownership interests in covered funds impose costs on banking entities, as also discussed by a number of commenters.[1106] Under the final rule, banking entities are able to engage in potentially profitable market making and underwriting in ownership interests in covered funds that they do not advise or organize or offer without the value of any ownership interests of the covered fund acquired or retained in connection with underwriting or market making-related activities becoming subject to aggregate limits and capital deduction. Some commenters noted that this amendment would facilitate capital-raising activities of covered funds,[1107] increase liquidity, and generally benefit the marketplace.[1108] The SEC agrees with these commenters and continues to believe that SEC-regulated banking

[1100] *See, e.g.,* IIB.

[1101] *See, e.g.,* JBA.

[1102] *Id.*

[1103] *See* IIB.

[1104] *See, e.g.,* SIFMA.

[1105] *See, e.g.,* SIFMA and ISDA.

[1106] *See, e.g.,* BPI; IIB; SIFMA; ABA and Goldman Sachs.

[1107] *See* SIFMA.

[1108] *See* ISDA.

entities will benefit from this amendment to the extent that they engage in underwriting and market making activities involving ownership interests in covered funds, or to the extent that they restricted or eliminated such activities as a result of the requirements in the 2013 rule. These benefits may also, at least partially, flow to funds and investors in those covered funds. In addition, as some commenters pointed out,[1109] banking entities may become more willing and able to underwrite and make markets in ownership interests in covered funds.

Some commenters indicated that these amendments would greatly increase banking entities' exposure to interests in covered funds, which would entail additional risks.[1110] For example, the removal of the guarantee language in § ▮▮.11(c)(2) would allow dealers to have arrangements such as a put option on the ownership interest in the covered fund, which could expose the banking entity to additional risk. The SEC continues to recognize that ownership interests in covered funds expose banking entities to the risks related to covered funds. The SEC agrees with the commenters that it is possible that covered fund ownership interests acquired or retained by a banking entity acting as an underwriter or engaged in market making-related activities may lead to losses for banking entities.[1111] However, the SEC also continues to recognize that the risks of market making or underwriting of ownership interests in covered funds are substantively similar to the risks of market making or underwriting of otherwise comparable financial instruments, the activity which is expressly permitted by section 13 of the BHC Act. Therefore, the same general tensions discussed in section V.F.3.c of this **SUPPLEMENTARY INFORMATION** between potential benefits for capital formation and liquidity and potential costs related to banking entity risk exposures and market fragility apply to banking entities' underwriting and market making activities involving ownership interests in covered funds and other types of securities.

Second, the final rule amends section § ▮▮.13(a) of the 2013 rule to expand the scope of permissible risk-mitigating hedging activities involving ownership interests in covered funds, and to remove the demonstrability requirement of the risk-mitigating hedging exemption for covered funds activities, in each case as proposed.[1112] Under the final rule, in addition to being able to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedge with respect to certain employee compensation agreements as permitted under the 2013 rule, the banking entity will be able to acquire or retain an ownership interest in a covered fund when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund. Some commenters stated that acquiring or retaining ownership interests in covered funds as a hedge when acting as intermediary on behalf of a customer accommodates client facilitation and related risk management activities.[1113] The SEC agrees with those commenters and continues to recognize that the 2013 rule's restrictions on risk-mitigating hedging activities with respect to ownership interests in covered funds limit banking entities' ability to hedge the risks of fund-linked derivatives through ownership interests in the covered funds referenced by those derivatives. In addition, in the proposal the SEC recognized that, as a result of the approach in the 2013 rule, banking entities may not be able to participate in offering certain customer facilitating products related to covered funds.[1114] The final rule is likely to benefit banking entities and their customers, as well as bank-affiliated advisers of covered funds, as the final rule increases the ability of banking entities to facilitate customer-facing transactions while hedging banking entities' own risk exposure.[1115] As a result, this amendment may increase banking entity intermediation and provide customers with more efficient access to the risks and returns of covered funds. To the degree that banking entities' acquisition or retention of ownership interests in covered funds to hedge customer-facing transactions may facilitate banking entities' engagement in customer-facing transactions, customers of banking entities may benefit from greater availability of financial instruments providing exposure to covered funds and related intermediation. Banking entities' ability to hedge customer-facing transactions through the acquisition or retention of ownership interests in covered funds may be particularly valuable as private capital plays an increasingly important role in U.S. capital markets and firm financing.

The SEC recognizes that, under certain circumstances, an increased ability of banking entities to acquire or retain ownership interests in covered funds in connection with risk-mitigating hedging activities may result in banking entities' exposure to greater risk.[1116] Some commenters supported this view.[1117] The SEC continues to recognize that banking entities' transactions in fund-linked products that reference covered funds with customers can expose a banking entity to risk in cases where a customer fails to perform, transforming the banking entity's covered fund hedge of the customer trade into an unhedged, and potentially illiquid, position in the covered fund (unless and until the banking entity takes action to hedge this exposure and bears the corresponding costs of hedging). However, the SEC also continues to recognize that such counterparty default risk is present in any principal transaction in illiquid financial instruments, including when facilitating customer trades in the securities in which covered funds invest, as well as in market making and underwriting activities. Commenters also recognized this.[1118] The SEC continues to note that, under the final rule, risk-mitigating hedging transactions involving covered funds must be conducted consistent with the other requirements of the 2013 rule, including the requirements with respect to risk-mitigating hedging transactions. For example, such transactions must be made in accordance with the banking entity's written policies, procedures, and internal controls; not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously with the risk-mitigating hedging requirements; and be subject to continuing review, monitoring, and management by the banking entity. Therefore, the SEC continues to believe that hedging and customer facilitation in ownership interests in covered funds does not necessarily pose a greater risk to banking entities than hedging or customer facilitation in similar financial instruments that is permissible under the 2013 rule.

Third, the final rule amends section § ▮▮.13(b)(4) of the 2013 rule to remove the financing prong of the foreign fund exemption and formally incorporates existing staff guidance regarding the marketing of ownership

[1109] *See, e.g.,* BPI.

[1110] *See, e.g.,* Volcker Alliance; AFR and Bean.

[1111] *See, e.g.,* AFR and Data Boiler.

[1112] The effects of removal of demonstrability requirement are discussed in section V.F.3.c.

[1113] *See, e.g.,* BPI and FSF.

[1114] *See* 83 FR at 33547–33549.

[1115] This was also supported by commenters. *See, e.g.,* BPI; Forum; ISDA and SIFMA.

[1116] 79 FR at 5737.

[1117] *See, e.g.,* AFR and Volcker Alliance.

[1118] *See, e.g.,* SIFMA; Forum and ISDA.

interests in foreign funds to U.S. residents into section § ▮ ▮.13(b)(3).[1119] Under the final rule, a foreign banking entity is able to acquire or retain ownership interests in and sponsor covered funds with financing for the banking entity's ownership or sponsorship provided, directly or indirectly, by branches or affiliates of the banking entity, including SEC-regulated dealers, that are located in the United States or organized under the laws of the United States or any state. The costs, benefits, and effects on efficiency, competition, and capital formation of this amendment generally parallel those of the removal of the financing prong with respect to trading activity outside of the United States in section V.F.3.e of this SUPPLEMENTARY INFORMATION.[1120]

In light of commenters' responses,[1121] the SEC continues to believe that foreign banking entities may benefit from the final rule and enjoy greater flexibility in financing their covered fund activity. In addition, allowing foreign banking entities to obtain financing of covered fund transactions from U.S.-dealer affiliates may reduce costs to foreign banking entities as the amendment may decrease their need to rely on foreign dealer affiliates solely for the purposes of avoiding the compliance costs and prohibitions of the 2013 rule. This may increase the operational efficiency of covered fund activity by foreign banking entities outside the United States.

Other commenters indicated that elimination of the financing prong could result in a U.S. branch or affiliate that extends financing to bear some risks.[1122] The SEC agrees with the commenters and continues to recognize that the economic exposure and risks of foreign banking entities' covered funds activities may be incurred not just by the foreign banking entities, but by U.S. entities financing the covered fund ownership interests, *e.g.,* through margin loans covering particular transactions. However, the SEC also continues to note that the final rule retains the 2013 rule's requirement that the investment or sponsorship, including any related hedging, is not accounted for as principal by any U.S. branch or affiliate.[1123] The SEC continues to believe that concerns about the size of U.S. banking entity risk exposures are less relevant when the covered fund activity is conducted by, and the risk consolidates to, foreign banking entities. Moreover, as noted above, U.S. banking entities providing financing to their foreign banking entity affiliates are likely to be separately subject to a full range of capital, margin, and other obligations unrelated to section 13 of the BHC Act, which may further mitigate risks to the U.S. branches and affiliates of foreign banking entities.

ii. Efficiency, Competition, and Capital Formation

As discussed above, the SEC believes that the final rule's amendments to the covered fund provisions in subpart C provide banking entities with greater flexibility in underwriting, market making, and hedging ownership interests in covered funds. To the extent that the 2013 rule's restrictions on underwriting and market making with interests in covered funds limit fund formation, the final rule may reduce long-term compliance costs and, as a result, increase capital formation. In addition, to the extent that banking entities experience a reduction in compliance costs and an increased ability to accommodate clients and perform risk management activities, the willingness of SEC-regulated entities to commit capital and take on underlying risk exposures may increase, which may enhance capital formation.

The final rule may affect competition between foreign and domestic entities, as foreign banking entities may benefit from the final rule and enjoy greater flexibility in financing their covered fund activity. To the extent that costs of compliance with the ''financing prong'' of the 2013 rule's foreign fund exemption may represent barriers to entry for foreign banking entities' covered fund activities, the final rule may increase foreign banking entities' operational efficiency and promote their sponsorship and financing of covered funds.

The final rule's amendments to § ▮ ▮.11 and § ▮ ▮.13 do not change the information available to market participants, and the SEC does not believe that these amendments are likely to have an effect on informational efficiency. To the degree that these amendments may provide banking entities with more flexibility to underwrite, make markets in, and hedge ownership interests in covered funds, and to the extent these activities facilitate capital formation, these amendments may improve allocative efficiency.

iii. Alternatives

The agencies considered alternatives that would scope out from calculation of the per-fund limit, aggregate fund limit, and capital deduction for banking entities all ownership interests acquired or retained by banking entities in connection with other underwriting and market making. For example, the agencies considered excluding the value of ownership interests acquired or retained in connection with underwriting or market making-related activities with respect to covered funds offered or organized by the banking entity from the calculation of the per-fund and aggregate limits and capital deductions.[1124] If the agencies had adopted this alternative, this would have provided dealers a level of flexibility in underwriting and making markets in ownership interests in covered funds that is more similar to the level of flexibility for dealers in conducting these activities with respect to all other types of financial instruments, including the underlying financial instruments owned by the same covered funds.

Compliance with the 2013 rule for covered funds imposes costs on banking entities. To the extent that, under the baseline, such costs prevent banking entities that are dealers from making markets in or underwriting certain financial instruments, this alternative would enable them to engage in potentially profitable market making in and underwriting ownership interests in covered funds. The benefits of this alternative may also flow through to funds, investors, and customers as

[1119] The SEC understands that, as a practical matter, market participants have adjusted their activity in light of the FAQs regarding the marketing restriction. *See supra* note 59, FAQ 13. Hence, the SEC continues to believe that the economic effects of the amendment to incorporate existing staff guidance are likely to be de minimis, and the SEC focuses this discussion on the removal of the financing prong.

[1120] In addition, the agencies confirmed in this SUPPLEMENTARY INFORMATION that the foreign fund exemption (1) permits the U.S. personnel and operations of a foreign banking entity to act as an investment adviser to a covered fund in certain circumstances and (2) 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. To the extent that foreign banking entities were restricting (1) hiring of U.S. personnel to provide investment advice and recommend investment selections to the manager or general partner of a covered fund relying on the foreign fund exemption, or (2) engagement of non-affiliated U.S. investment advisers due to uncertainty about the 2013 rule, foreign banking entities may be more likely to hire U.S. personnel to provide such services, and non-affiliated U.S. investment advisers may become better able to compete for the foreign banking entity's investment mandates.

[1121] Several commenters supported removing the financing prong from the foreign fund exemption. *See, e.g.,* BPI; EBF; IIB; JBA and New England Council.

[1122] *See, e.g.,* Better Markets and CAP.

[1123] Some commenters supported this view. *See, e.g.,* EBF and BPI.

[1124] Some commenters supported this alternative. *See, e.g.,* ISDA.

banking entities may become more willing and able to underwrite and make markets in products linked to covered funds and to provide customers with an economic interest in the profits and losses of covered funds. This may increase investor access to the returns and risks of private funds, which may be particularly valuable when issuers are increasingly relying on private capital and delaying public offerings. Finally, the increased ability of banking entities to engage in market making and underwriting activities with respect to covered funds under this alternative may have increased market quality for covered funds that are traded.

The SEC also continues to recognize that transactions in covered funds—including transactions with customers, and holdings of ownership interests in covered funds related to underwriting and market making—necessarily involve the risk of losses. However, the risks of market making or underwriting by banking entities of financial instruments held by the covered fund, or financial instruments or securities that are otherwise similar to covered funds, are substantively similar. Therefore, the same tensions among the economic effects discussed in section V.F.3.c of this **SUPPLEMENTARY INFORMATION** between potential benefits to capital formation and liquidity and potential costs related to bank risk exposures and market fragility apply to both banking entity interests from underwriting and market making in financial instruments and underwriting and market making in covered funds. It is not clear that the existence of a legal and management structure of a covered fund per se changes the economic risk exposure of banking entities, and, thus, the capital formation and other tensions of the economic effects discussed above. Therefore, the SEC continues to believe that this alternative would simply involve a more consistent treatment of financial instruments and interests in covered funds as it pertains to underwriting and market making. However, as discussed above in section V.F.1 of this **SUPPLEMENTARY INFORMATION**, some of the effects of the 2013 rule's provisions are difficult to evaluate outside of economic downturns, and the SEC is unable to measure the amount of capital formation or liquidity in covered funds or investments of the covered funds that does not occur because of the existing treatment of underwriting and market making activities by banking entities involving covered funds.

g. Compliance Program

The SEC continues to recognize that the scope and breadth of the compliance obligations under the 2013 rule impose significant costs on banking entities, which may be particularly burdensome for smaller entities. For example, in the proposal, the SEC cited a market participants' estimate that some banking entities have added as many as 2,500 pages, per institution, of policies, procedures, mandates, and controls (which need to be monitored and updated on an ongoing basis) [1125] for purposes of compliance with the 2013 rule, and that some banking entities may spend, on average, more than 10,000 hours on training each year.[1126] The SEC also cited a market participants' estimate that some banking entities may have 15 regularly meeting committees and forums, with as many as 50 participants per institution dedicated to compliance with the 2013 rule.[1127]

The compliance regime of the 2013 rule and related burdens may reduce the profitability of covered activities by dealers and investment advisers that are banking entities and may be passed along to customers or clients in the form of reduced provision of services or higher service costs. Moreover, the SEC recognizes that the extensive compliance program under the 2013 rule may detract resources of banking entities and their compliance departments and supervisors from other compliance matters, risk management, and supervision. Finally, prescriptive compliance requirements may not optimally reflect the organizational structures, governance mechanisms, or risk management practices of complex, innovative, and global banking entities. However, the SEC agrees with commenters [1128] that compliance programs are important to support the safety and soundness of the U.S. financial markets.

i. Costs and Benefits

The final rule is expected to lower compliance burdens in two ways. First, the SEC continues to believe that the amendments would increase flexibility in complying with the final rule for banking entities without significant trading assets and liabilities, reducing compliance costs for these entities. Second, the adopted amendments would streamline the compliance program for banking entities with significant trading assets and liabilities. The SEC continues to believe that, to the extent that the requirements in the 2013 rule are duplicative and that maintaining compliance systems to comply with both the general and an enhanced compliance program requirements is inefficient, banking entities with significant trading assets and liabilities may benefit from the amendments. The specific final amendments are discussed below.

For Group C entities, the agencies are adopting presumed compliance with proprietary trading and covered fund prohibitions. Some commenters noted that the presumed compliance standard proposed for Group C entities may benefit entities with very low levels of trading activity.[1129] In light of the commenters' responses, the SEC continues to believe that the presumption of compliance will provide Group C entities with additional compliance flexibility. The SEC estimates that approximately 97 broker-dealers that hold 3.6% of assets held by broker-dealers subject to the final rule would be able to avail themselves of the rebuttable presumption of compliance and would not have to apply the final rule's compliance program requirements. Out of these 97 broker-dealers, 28 are subject to the enhanced requirements under the 2013 rule, 51 are subject to the standard compliance requirements under the 2013 rule, and 18 qualify for the simplified compliance regime under the 2013 rule. As discussed in section V.B, the agencies estimate recordkeeping or reporting burden reductions related to presumed compliance with the final rule are as high as $1,648,812.[1130]

Some commenters expressed concern that Group C entities may experience uncertainty because of the absence of specific guidance about what events would trigger an agency to rebut the presumption of compliance,[1131] and, as a result, incur compliance costs related to establishing internal systems and controls in anticipation of potential rebuttal of the presumption.[1132] To the extent that some Group C entities experience this uncertainty and costs, they may not fully enjoy the benefits of presumed compliance. One commenter estimated that smaller banking entities would likely incur an additional one-time cost of $50,000–$100,000 in

[1125] *See* 83 FR 33432.

[1126] *Id.*

[1127] *Id.*

[1128] *See, e.g.,* AFR and Bean.

[1129] *See, e.g.,* B&F Capital Markets Inc.

[1130] *See* section V.B. Ongoing cost reduction for broker-dealers: (40 hours per firm × 18 broker-dealers + 265 hours per firm × 79 broker-dealers) × 0.18 dealer weight × (Attorney at $423 per hour) = $1,648,812.

[1131] *See, e.g.,* Chatham; ABA and SIFMA.

[1132] *See, e.g.,* Covington; Chatham; EBF; JBA and Data Boiler.

consulting or legal advice fees.[1133] Using this estimate, the total initial cost related to consulting or legal advice fees for Group C broker-dealers may range between $873,000 and $1,746,000.[1134]

Some commenters opposed the presumption of compliance.[1135] The SEC continues to recognize that the presumption of compliance for Group C entities may increase the risks of non-compliance with the statute. However, the SEC also continues to note that the amendments do not waive the proprietary trading and covered fund prohibitions of section 13 of the BHC Act for such entities.

For Group B entities, the agencies are adopting the simplified compliance program as proposed. Some commenters expressed support for this approach for Group B entities.[1136] In the proposal, the SEC recognized that existing compliance program requirements may burden entities that engage in little covered trading activity but have larger total assets.[1137] The SEC continues to recognize that this amendment may reduce costs for banking entities that have more than $10 billion in total assets but do not have significant trading assets and liabilities, as these banking entities do not qualify for the simplified compliance program under the 2013 rule. As shown in Table 2, the SEC estimates that 66 broker-dealers would qualify for the simplified compliance regime under the final rule. As discussed in section V.B, the agencies estimate recordkeeping or reporting burden reductions related to the simplified compliance program for Group B broker-dealers to be $1,130,679 for registered broker-dealers and up to $582,471 for entities that may choose to register as SBSDs.[1138]

The agencies are amending covered fund recordkeeping requirements to apply to Group A entities only, rather than to banking entities with over $10 billion in total assets. The SEC believes that the covered funds activities of banking entities without significant trading assets and liabilities may generally be smaller in scale and less complex than those of banking entities with significant trading assets and liabilities. Thus, the value of additional documentation requirements for banking entities without significant trading assets and liabilities may be lower. The final amendment reflects these considerations and may reduce the costs associated with these covered funds recordkeeping requirements by reducing the number of banking entities subject to these requirements.[1139] The SEC continues to note that entities with moderate trading assets and liabilities would still be required to comply with all the covered fund provisions and that the proposal simply eliminates recordkeeping for the purposes of demonstrating compliance. However, in general, the SEC believes that SEC oversight of dealers and investment advisers of covered funds should not be adversely affected, as the remaining compliance requirements will be sufficient to monitor compliance with the statute. As discussed in section V.B, the agencies estimate recordkeeping or reporting burden reductions related to the covered fund recordkeeping requirements to be $2,208,060 for registered broker-dealers and up to $517,752 for entities that may choose to register as SBSDs.[1140]

The agencies are also adopting the removal of the requirements in Appendix B of the 2013 rule as proposed, with an exception for the CEO attestation. The removal of Appendix B requirements will affect all banking entities that have trading assets and liabilities above $10 billion, as well as banking entities that have total consolidated assets of $50 billion or more. Some commenters expressed general support for this amendment.[1141] In addition, some commenters indicated that compliance with Appendix B required entities to develop and administer an enhanced compliance program that may not be tailored to the business model or risks of specific institutions.[1142] Further, in the proposal the SEC cited a market participants' estimate that some banking entities have established as many as 500 controls related to Appendix B obligations, some of which may be duplicating other policies and procedures designed as part of prudential safety and soundness.[1143] In light of these comments, the SEC continues to believe that compliance with Appendix B may impose significant costs on SEC-regulated banking entities and that removal of the Appendix B requirements may significantly reduce the number and complexity of the compliance requirements to which such entities are subject. The SEC estimates that there are 122 broker-dealers that may experience reduced compliance costs as a result of this amendment, among which 28 are Group C entities, 58 are Group B entities and 36 are Group A entities. As discussed in section V.B, the removal of Appendix B requirements will result in ongoing annual cost savings estimated as $10,217,988 for registered broker-dealers and up to $2,847,636 for entities that may choose to register as SBSDs.[1144]

Some commenters opposed the removal of Appendix B, arguing that, given the size of affected holding companies, the 2013 rule's stringent compliance regime may help reduce compliance risks related to the substantive prohibitions of section 13 of the BHC Act and the 2013 rule.[1145] However, the SEC notes that, under the final rule, both Group A and Group B entities will be required to establish and maintain a compliance program under § ■ ■.20.

Finally, the agencies are adopting the amendment to require CEO attestation

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[1133] *See* Data Boiler.

[1134] Initial set-up burden increase for broker-dealers: 97 broker-dealers × 0.18 dealer weight × $100,000 = $1,746,000. Using the lower bound: 97 broker-dealers × 0.18 dealer weight × $50,000 = $873,000.

[1135] *See, e.g.,* Occupy the SEC and Data Boiler.

[1136] *See, e.g.,* CFA and JBA.

[1137] *See* 83 FR 33432.

[1138] Cost reduction for broker-dealers: 225 hours per firm × 0.18 dealer weight × 66 broker-dealers × (Attorney at $423 per hour) = $1,130,679.

Cost reductions for entities that may register as SBSDs may be as high as 225 hours per firm × 0.18 dealer weight × 34 SBSDs × (Attorney at $423 per hour) = $582,471. The estimate for SBSDs assumes that 34 SBSDs not already registered as broker-dealers would be Group B entities and so may overestimate the cost savings.

[1139] As discussed in section V.F.2.c, RIAs do not typically engage in proprietary trading, and the SEC continues to believe that they will not be affected by the final rule as it relates to proprietary trading. In addition, the SEC does not have the information necessary to quantify the compliance program costs at the RIA level of a BHC. Thus, the SEC does not allocate cost savings from monetized PRA burdens to bank-affiliated RIAs from the proposed Appendix B amendments. To the degree that some bank-affiliated RIAs may be extending compliance resources and systems independent of the affiliated holding company and other affiliates and subsidiaries, this approach may be underestimating the cost savings from the final rule.

[1140] Cost reduction for broker-dealers: 200 hours per firm × 0.18 dealer weight × 145 broker-dealers × (Attorney at $423 per hour) = $2,208,060.

Cost reductions for entities that may register as SBSDs may be as high as 200 hours per firm × 0.18 dealer weight × 34 SBSDs × (Attorney at $423 per hour) = $517,752. The estimate for SBSDs assumes that all 34 SBSDs not already registered as broker-dealers would be Group B entities and so may overestimate the cost savings.

[1141] *See, e.g.,* Insurance Coalition; Real Estate Associations; CREFC; Credit Suisse; JBA; FSF and ABA.

[1142] *See, e.g.,* Credit Suisse; CREFC; SIFMA and Capital One et al.

[1143] *See* 83 FR at 33551.

[1144] Cost reduction for broker-dealers: 1,100 hours per firm × 0.18 dealer weight × 122 broker-dealers × (Attorney at $423 per hour) = $10,217,988.

Cost reductions for entities that may register as SBSDs may be as high as 1,100 hours per firm × 0.18 dealer weight × 34 SBSDs × (Attorney at $423 per hour) = $ 2,847,636. The estimate for SBSDs assumes that all 34 SBSDs not already registered as broker-dealers would be subject to Appendix B requirements and so may overestimate the cost savings.

[1145] *See, e.g.,* AFR and Bean.

for Group A entities only.[1146] In the proposal, the SEC recognized that the CEO attestation process is costly and cited market participants' estimates that some banking entities may spend more than 1,700 hours on the CEO attestation process and that the elimination of this requirement may reduce time dedicated towards the compliance program by as much as 10%.[1147] In addition, as indicated by some commenters, the CEO attestation requirement requires banking entities to undertake costly internal compliance efforts that are not consistent with the activities or risks of such firms.[1148] Therefore, the SEC believes that the amendments to the application of the CEO attestation requirement will benefit SEC-regulated banking entities and their holding companies that do not have significant trading assets and liabilities but are subject to the CEO requirement under the 2013 rule.

The SEC continues to note that, under the 2013 rule, SEC-regulated banking entities have flexibility to comply with the attestation requirement either at the SEC-registrant or at the holding-company level. In 2019, the SEC received a total of 55 attestations that cover compliance for 2018, including 14 attestations directly from SEC registrants, none of which are Group A entities. Therefore, the SEC expects that, under the final rule, these registrants would no longer be providing CEO attestations. The SEC estimates that there are 122 broker-dealers that are subsidiaries or affiliates of bank holding companies that are required to comply with the CEO attestation requirement under the 2013 rule. The SEC estimates that under the final rule this number will decrease to 36 Group A broker-dealers. Therefore, the amendment may result in annual cost savings from $654,804 to $774,000 for broker-dealers and up to between $258,876 and $306,000 for entities that may choose to register as SBSDs.[1149]

The agencies are also adopting notice and response procedures related to sections ▮▮.3(b)(4), ▮▮.4(c)(4), ▮▮.20(g)(2), and ▮▮.20(h) of the final rule. As a result, all broker-dealers and entities that may potentially register as SBSDs may experience increases in initial reporting set-up costs. As discussed in section V.B, the agencies estimate the initial set-up reporting burden increase related to the notice and response procedures to be $303,037 for registered broker-dealers and up to $51,775 for entities that may choose to register as SBSDs.[1150] In addition, as discussed in section V.B, the agencies may exercise a reservation of authority and seek to rebut the presumption in section ▮▮.3(b)(4) in accordance with the notice and response procedures in section ▮▮.20(i) of the final rule, involving a burden of up to 20 hours per entity per response. In such cases, an SEC-regulated banking entity may incur a cost of up to $1,523 (=20 hours per response × 0.18 dealer weight × Attorney at $423 per hour) per response. The SEC is unable to estimate how many entities may bear such costs since this figure will depend on how SEC-regulated banking entities may choose to comply with the final rule.

ii. Efficiency, Competition, and Capital Formation

Under the final amendments, both Group A and Group B entities will benefit from reduced compliance program requirements and Group C entities will be presumed compliant with prohibitions of subparts B and C of the final rule. To the extent that compliance program requirements for Group B entities are less costly, Group A entities close to the $20 billion threshold may choose to manage down their trading book such that they would qualify for the simplified compliance program, resulting in more competition among entities that are close to the threshold. Similarly, the final rule may incentivize Group B entities close to the $1 billion threshold to rebalance their trading book in order to qualify for the presumed compliance treatment of Group C entities. Such management of the trading book may reduce the risk of each individual banking entity and may decrease the risks to the financial system. The SEC notes that entities are likely to weigh potential cost savings related to lighter compliance requirements for Group B and Group C entities against the costs of reducing trading activity below the $20 billion and $1 billion thresholds. Therefore, this competition effect may be particularly significant for Group A entities that are close to the $20 billion threshold and for Group B entities that are close to the $1 billion threshold.

Since the compliance requirements do not affect the scope of information available to investors, the SEC does not anticipate effects on informational efficiency to be significant. To the extent that some dealers are experiencing large compliance costs and partially or fully passing them along to customers in the form of reduced access to capital or higher cost of capital, the amendment may reduce costs of and increase access to capital.

iii. Alternatives

As an alternative, the agencies could have applied the CEO attestation requirement to both Group A and Group B entities. Under this alternative, some banking entities would have become subject to the CEO attestation requirement for the first time, as noted by some commenters.[1151] As discussed above and noted by commenters,[1152] the SEC continues to recognize that Group B entities pose lower risks to the financial system that may not necessarily justify a costly and stringent compliance regime that requires CEO attestation.

As other alternatives, the agencies could have required CEO attestations for Group A entities only if they have over $50 billion in total assets; removed the CEO attestation requirement; or allowed other senior officers, such as the chief compliance officer (CCO), to provide the requisite attestation for some or all affected banking entities. As discussed above, the SEC recognized in the proposal that the CEO attestation process is costly and that some market participants estimated that some banking entities may spend more than 1,700 hours on the CEO attestation process and that eliminating this requirement may reduce time dedicated toward the compliance program by as

[1146] As a baseline matter, under the 2013 rule, the CEO is required to annually attest that the banking entity has in place processes to establish, maintain, enforce, review, test, and modify the compliance program established pursuant to Appendix B in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and the 2013 rule.

[1147] *See* 83 FR at 33551.

[1148] *See, e.g.,* Capital One, et al.

[1149] Cost reduction for broker-dealers: 100 hours per firm × 0.18 dealer weight × 86 broker-dealers × (Attorney at $423 per hour) = $654,804. Alternatively, using the CEO hourly rate, cost reduction for broker-dealers is: 100 hours per firm × 78 broker-dealers × 0.18 dealer weight × (CEO at $500 per hour) = $774,000.

Cost reduction for entities that may register as SBSDs may be as high as: 100 hours per firm × 0.18 dealer weight × 34 SBSDs × (Attorney at $423 per hour) = $258,876. Alternatively, using the CEO hourly rate, cost reduction for broker-dealers is: 100 hours per firm × 34 SBSDs × 0.18 dealer weight × (CEO at $500 per hour) = $306,000. The SEC assumes that all entities that may register as SBSDs would be subject to the CEO attestation requirement, and so may overestimate the cost savings.

[1150] Initial set-up reporting burden increase for broker-dealers: 20 hours per firm × 0.18 dealer weight × 199 broker-dealers × (Attorney at $423 per hour) = $303,037.

Initial set-up reporting burden increase for entities that may register as SBSDs may be as high as: 20 hours per firm × 0.18 dealer weight × 34 SBSDs × (Attorney at $423 per hour) = $51,775.

[1151] *See, e.g.,* IIB.

[1152] *See, e.g.,* Capital One et al.; BB&T; ABA; Arvest; State Street and IIB.

much as 10%.[1153] Under the aforementioned alternatives, more SEC-regulated banking entities would generally experience larger cost reductions. However, as discussed in section IV.D.1, the agencies continue to believe that incorporating the CEO attestation requirement into § __.20(c) for Group A banking entities will help to ensure that the compliance program established pursuant to that section is reasonably designed to achieve compliance with section 13 of the BHC Act and the final rule.

As an alternative, the agencies could have included a knowledge qualifier for CEO attestation. Since CEOs of banking entities do not necessarily know every single policy, procedure, process, and control, as pointed out by some commenters,[1154] they may rely on multiple layers of sub-attestations within a banking entity. If CEOs of banking entities are risk averse, they may require additional liability insurance, higher compensation, or lower incentive pay as a fraction of overall compensation. Under this alternative, such effects stemming from risk aversion would be mitigated. However, the attestation may also serve as a disciplining mechanism and incentivize compliance. In addition, as one commenter stated, CEOs of publically traded banking entities regularly attest that their company's annual and quarterly reports are accurate and complete and that internal controls have been established and maintained.[1155] The SEC also notes that the covered activities of larger and more complex banking entities with higher volumes of trading activity may involve risk exposures with a larger potential for systemic risk and conflicts of interest.

The agencies also recognize that CEO attestation may be costly for banking entities affiliated with foreign banking organizations. For example, the SEC noted in the proposal that one foreign firm reported that it organized and managed a global controls sub-certification process that takes 6 months to complete and involves over 400 staff (including over 260 outside of the United States) in order for the CEO to sign and deliver the annual attestation.[1156] As an alternative, the agencies could have proposed exempting banking entities affiliated with a foreign banking organization from the CEO attestation requirement. Under the 2013 rule, the requirement covers only the U.S. operations of a foreign banking entity and not its foreign operations. Similar to the analysis of the final amendment to trading outside of the United States, this alternative may decrease compliance costs and increase trading activity by foreign banking entities in the United States but result in losses in market share and profitability for U.S. banking entities that would remain subject to the attestation requirement and would be placed at a competitive disadvantage as a result.

h. Metrics

i. Costs and Benefits

In the proposal, the SEC discussed the compliance burdens related to the metrics reporting and recordkeeping requirements under the 2013 rule. For example, the SEC reported that a market participant estimated that the average cost of collecting and filing metrics subject to the reporting requirements may be as high as $2 million per year per participant, and that market participants may submit an average of over 5 million data points in each filing.[1157] The SEC also reported an estimate from a market participant incurring approximately $3 million in costs associated with the buildout of new IT infrastructure and system enhancements and estimated that this IT infrastructure will require at least $250,000 in maintenance and operating costs year-to-year.[1158] In addition, the SEC noted that the same firm estimated costs related to compliance consultants assisting with the construction of the 2013 rule compliance regime at $3 million.[1159]

The SEC continues to believe that the metrics reporting and recordkeeping requirements of the 2013 rule may involve large compliance costs.[1160] The agencies have received comment that the proposed amendments do not streamline metrics reporting and recordkeeping requirements but impose costly new requirements.[1161] Moreover, the agencies received comment that the new qualitative information requirements, such as the trading desk information, are unlikely to enhance review by regulators.[1162] In addition, the agencies received comment that even where underlying data is already collected by reporters in the regular course of business and for regulatory compliance, reporters will still incur costs of determining how best to compile and standardize the information.[1163]

As discussed below, the SEC continues to recognize that some aspects of the final rule may impose new requirements on reporters. Moreover, the SEC continues to emphasize that quantitative metrics do not clearly identify impermissible proprietary trading, but, rather, inform general agency oversight and supervision. As discussed further below, in response to the comments received, the SEC has revised its estimates of the compliance costs of various amendments and burden savings from metrics amendments as a whole. Importantly, the final metrics amendments include changes from the proposed approach—changes that both reduce the scope of new requirements and eliminate other existing quantitative metrics, such as risk factor sensitivities. For example, as discussed in section IV.E, the agencies estimate that the final rule may significantly reduce both the number of reported data items (by approximately 67%) and the overall volume of submissions (by approximately 94%) relative to baseline.

Overall, the SEC believes that the final rule reduces the costs of metrics requirements for reporters, eliminating certain metrics on the basis of regulatory experience with the data and provides some entities with additional reporting time. Broadly, metrics reporting provides information for regulatory oversight and supervision but presents compliance burdens for registrants. The balance of these effects turns on the value of different metrics in evaluating covered trading activity for compliance with the rule, as well as their usefulness for risk assessment and general supervision. These effects are discussed with respect to each final amendment in the sections that follow.

The SEC considered how to assess the costs of the final rule for SEC-regulated banking entities. The metrics costs are generally estimated at the holding company level for each reporter.[1164] The SEC allocates these costs to the affiliated

[1153] *See* 83 FR at 33551.

[1154] *See, e.g.,* FSF; BPI and SIFMA.

[1155] *See, e.g.,* BOK.

[1156] *See* 83 FR at 33552.

[1157] *See* 83 FR at 33539.

[1158] *Id.*

[1159] To the extent that costs related to compliance consulting include both costs of metrics reporting and related systems, as well as costs related to other compliance requirements under the 2013 rule, the SEC cannot estimate the firm's all-in metrics reporting costs.

[1160] *See, e.g.,* 83 FR at 33538.

[1161] *See, e.g.,* CCMC; JBA; Committee on Capital Markets; SIFMA Annex C and IIB.

[1162] *See* SIFMA.

[1163] *Id.*

[1164] The SEC currently receives metrics from 18 entities, including 2 reporters that are below $10 billion in trading assets and liabilities. Since voluntary reporters are not constrained by the requirements of the amendment, they are not reflected in the SEC's cost estimates. In addition, the SEC believes that the additional systems costs estimated here will be incurred at the holding company level and scope in the trading activity of all SEC-registered banking entity affiliates.

SEC-regulated banking entity.[1165] The SEC believes that estimating the cost savings of the final rule at the individual registrant level would be inconsistent with the SEC's understanding of how these entities are complying with the metrics reporting requirements of the 2013 rule. The SEC continues to believe that SEC-regulated banking entities within the same corporate group will collaborate with one another to comply with the final rule, to take advantage of efficiencies of scale. Further, the SEC continues to note that individual SEC-regulated banking entities may vary in the scope and type of activity they conduct and that not all entities within an organization subject to Appendix A engage in the types of covered trading activity for which metrics must be reported. Thus, to the extent that metrics compliance occurs at the holding company level, estimating costs at the registrant level may overstate the magnitude of the costs and cost savings for SEC-regulated entities as a result of the final rule.

The discussion that follows addresses the effects of the final rule on the reporting and recordkeeping burdens and other compliance costs for banking entities, the effects of the elimination and streamlining of certain metrics, the effects of extended time to report, and amendments related to the XML format.

(1) Reporting and Recordkeeping Burden for SEC-Regulated Banking Entities

The changes in reporting and recordkeeping burdens as a result of the final rule stem from four key groups of changes to the metrics reporting regime. First, the final rule requires metrics reporting for Group A entities only. Under the 2013 rule, banking entities with consolidated trading assets and liabilities above $10 billion are required to record and report certain quantitative measurements for each trading desk engaged in covered trading.[1166] Under the amended rules, entities with $20 billion or more in trading assets and liabilities would be required to furnish metrics. The SEC estimates that three metrics reporters that have affiliated broker-dealers required to submit metrics to the SEC under the 2013 rule will no longer be required to report metrics under the final rule.

Second, as discussed above, the agencies are narrowing the scope of many of the 2013 rule's metrics requirements or eliminating them as a whole. For example, the agencies are eliminating the Inventory Aging metric, the Stress Value-at-Risk (VaR) metric, and the Risk Factor Sensitivities metric. As discussed above, the agencies estimate that the final rule eliminates approximately 67% of data items by number and 94% of data by volume. The reduction in the volume of data required to be compiled, reviewed, and transmitted to the agencies is expected to decrease the volume of data that needs to be produced, manipulated, and submitted to the agencies for purposes of compliance with the 2013 rule.

Third, the amendment to the trading account definition may change the scope of desks required to report metrics. Specifically, some trading desks, such as some asset and liability management desks, under the 2013 rule, may be required to report metrics solely due to activity that falls within the 60-day rebuttable presumption. Because of the nature of their activity, such trading desks may face greater burdens of producing metrics that are routine for other trading desks. The elimination of the 60-day rebuttable presumption may eliminate the need for such desks to report metrics, removing related burdens.

Fourth, the agencies are adopting an amendment to require metrics reporting by all reporters on a quarterly basis within 30 days of the end of each calendar quarter. Under the 2013 rule, banking entities that report metrics and have less than $50 billion in consolidated trading assets and liabilities are required to report metrics for each quarter within 30 days of the end of that quarter. In contrast, under the 2013 rule, banking entities with total trading assets and liabilities equal to or above $50 billion are required to report metrics more frequently—each month within 10 days of the end of that month.[1167] As discussed further below, because processes enabling reporting under tight deadlines may generally be costlier, the SEC anticipates that the amended reporting requirements may reduce compliance costs for entities that are subject to the 2013 rule's metrics requirements and have more than $50 billion in trading assets and liabilities and may result in fewer resubmissions by such filers.

In the proposal, the SEC stated that reporters may incur systems-related costs of approximately $120,000 to $130,000, estimated at the level of the reporter. The agencies have received comment that the SEC's estimates of the costs of the metrics amendments are a significant underestimate, since reporters will need to revise all of their metrics reporting systems and embark on a new round of systems integration with multiple agencies independently.[1168] The commenter indicated that the exercise is not dissimilar from the initial implementation of the 2013 rule's metrics.[1169] Another commenter supported retaining requirements of the 2013 rule, since any metrics amendments would require modifications to measurement tools, involving burdens, testing time, and outsourcing costs of development staff.[1170]

The SEC agrees that compliance with the final rule will involve one-time costs to transition systems and compliance architecture to the metrics amendments for Group A entities, including the new requirements related to granular Transaction Volumes and Positions metrics, Comprehensive Profit and Loss Attribution, Trading Desk and Quantitative Measurements Identifying Information, and the elimination of reporting of other metrics (such as Inventory Turnover, Customer-Facing Trade Ratio, Risk Factor Sensitivities, and Stress VaR). The SEC notes that its analysis is specific to SEC registrants, and the estimates represent only a fraction of the compliance costs of holding companies allocated to affiliated SEC-regulated banking entities. Moreover, the SEC anticipates considerable variation in one-time system transition costs among reporters, depending on the size and complexity of their existing trading activity, the number of trading desks per reporter for the purposes of metrics reporting, the way in which reporters may organize reporting and compliance obligations for the purposes of, for instance, the market risk capital rule, and the complexity of their current systems. However, if transitioning reporting systems to meet the requirements of the final rule impose one-time costs and IT burdens comparable with those of the metrics requirements of the 2013 rule,[1171] the compliance costs related to the 2013 rule can be used to estimate potential one-time switching costs for some banking entities. In the proposal, the SEC reported an estimate from a market participant incurring approximately $3 million in costs associated with the buildout of new IT infrastructure and system enhancements.[1172] Using this estimate, the one-time costs related to transitioning metrics reporting to

1165 *See supra* note 1070.

1166 *See* 2013 rule § ▮▮.20(d) and Appendix A.

1167 *See* 2013 rule § ▮▮.20(d)(3).

1168 *See* SIFMA.

1169 *Id.*

1170 *See, e.g.,* JBA.

1171 *See* SIFMA.

1172 *Id.*

comply with the requirements of the final rule may be as high as $540,000 [1173] for SEC-regulated dealers affiliated with a single Group A metrics reporter and as high as $6,480,000 [1174] for all SEC-regulated entities affiliated with all reporters.

However, as discussed earlier in this section, the SEC believes that the final metrics amendments may reduce reporting and recordkeeping burdens.[1175] The SEC estimates that the amendments may decrease ongoing annual reporting and recordkeeping cost by $463,921.[1176] These figures reflect the estimated burden reductions net of any new systems costs imposed by the final rule.

(2) Elimination, Replacement, and Streamlining of Certain Metrics

As discussed above, the final rule includes a number of amendments eliminating, replacing, and streamlining metrics reporting. For example, the final rule eliminates the Inventory Aging, Stress VaR, and Risk Factor Sensitivities metrics, as well as replaces the Inventory Turnover with the Positions metric and the Customer Facing Trade Ratio with the Transaction Volumes metric. As discussed above, both the Transaction Volumes metric and the Positions metric will be required only by desks involved in underwriting or market making-related activity. The SEC continues to believe that the key balancing of economic effects from metrics reporting is between compliance burdens (which may be particularly significant for smaller entities) and the amount and usefulness of information provided for regulatory oversight of the 2013 rule, as well as for general supervision and oversight. As estimated above, the limitation of certain metrics to desks engaged in covered trading activities, elimination of the above metrics, and removal of the Stress VaR limit requirements is expected to reduce burdens related to reporting and recordkeeping for Group A entities. Although metrics do not allow the SEC to clearly identify proprietary trading from permitted market making, risk-mitigating hedging, or underwriting activity, certain metrics may provide additional information that is useful for regulatory oversight.

Replacement of Inventory Turnover With Positions and Customer-Facing Trade Ratio With Transaction Volumes

The final rule replaces the Inventory Turnover metric with the Market Value of Positions quantitative measurement and replaces the Customer-Facing Trade Ratio metric with the Transaction Volumes quantitative measurement. The Inventory Turnover and Customer-Facing Trade Ratio metrics are ratios that measure the turnover of a trading desk's inventory and compare the transactions involving customers and non-customers of the trading desk, respectively.

The Positions and Transaction Volumes metrics are expected to provide information about risk exposure and trading activity at a more granular level. Specifically, the final rule requires that banking entities provide the relevant agency with the underlying data used to calculate the ratios for each trading day, rather than providing more aggregated data over 30-, 60-, and 90-day calculation periods. By providing more granular data, the Positions metric, in conjunction with the Transaction Volumes metric, is expected to provide the SEC with the flexibility to calculate inventory turnover ratios and customer-facing trade ratios over any period of time, including a single trading day, allowing the use of the calculation method the SEC finds most effective for purposes of regulatory oversight.

Moreover, the new Positions and Transaction Volumes metrics will distinguish between securities and derivatives positions, unlike the Inventory Turnover and Customer-Facing Trade Ratio metrics. These metrics would require a banking entity to separately report the value of securities positions and the value of derivatives positions. While the Inventory Turnover and Customer-Facing Trade Ratio metrics require banking entities to use different methodologies for valuing securities positions and derivatives positions because of differences between these asset classes, these metrics currently require banking entities to aggregate such values for reporting purposes. By combining separate and distinct valuation types (*e.g.,* market value and notional value), the Inventory Turnover and Customer-Facing Trade Ratio metrics are providing less meaningful information than was intended by the 2013 rule. Therefore, requiring banking entities to disaggregate the value of securities positions and the value of derivatives positions for reporting purposes may enhance the usability of this information.

In addition to requiring separate reporting of the value of securities positions and the value of derivatives positions, the final rule would also streamline valuation method requirements for different product types. The removal of the notional value of derivative positions in the Positions metric avoids complexities related to mixing various calculation methods for notional value for different derivatives. For example, using delta-adjusted notional for options, bond equivalents for interest rate derivatives, commodity price adjusted values for commodity derivatives, and gross notional for other derivatives increases complexity and reduces comparability. Moreover, certain valuation methodologies required by the 2013 rule's Inventory Turnover and the Customer-Facing Trade Ratio metrics may not be otherwise used by banking entities (*e.g.,* for internal monitoring or external reporting purposes). Furthermore, the 2013 rule's requirements result in information being aggregated and furnished to the SEC in non-comparable units. At the same time, the final rule retains gross notional value of derivatives as part of the Transactions Volumes Metric. The SEC believes that changing market values of positions as well as the volume of derivative contracts in terms of notional are important measures of risk useful for ongoing agency oversight. Therefore, this aspect of the final rule may further enhance the usability of the information provided in the Positions metric.

Moreover, the valuation methods required under the final rule are intended to be more consistent with the agencies' understanding of how banking entities value securities and derivatives positions in other contexts, such as internal monitoring or external reporting purposes, which may allow them to leverage existing systems and

[1173] $3 million × 0.18 × 1 reporter = $540,000.

[1174] $540,000 × 12 reporters = $6,480,000.

[1175] In the proposal, the SEC estimated the effect on SEC-registered broker-dealers and entities that may register as SBS dealers by scaling per-reporter estimates by 0.18 and multiplying by the number of broker-dealers or SBSDs affiliated with reporters in an affected category. This approach assumes that reporters with multiple dealers may allocate metrics compliance costs savings to each dealer. The SEC now more conservatively allocates compliance cost savings to multiple dealers affiliated with a reporter as one dealer entity. This approach also avoids assuming that entities that may register as SBSDs that are not broker-dealers are affiliated with reporters with over $50 billion in trading assets and liabilities (TAL) and is consistent with how the SEC allocates systems costs related to metrics amendments.

[1176] Ongoing reporting cost reduction for SEC entities: [(55 hours per report ×12 reports per year × 9 reporters with over $50 billion) + (55 hours per report × 4 reports per year × 9 reporters with under $50 billion)¥(41 hours per report × 4 reports per year × 12 reporters with TAL above $20 billion)] × 0.18 dealer weight × (Attorney at $423 per hour) = $453,185.

Ongoing recordkeeping cost reduction for SEC entities: [(16 hours per firm × 9 reporters with over $50 billion + 13 hours per firm × 9 reporters with <$50 billion)¥(10 hours per firm × 12 reporters with >$20 billion TAL)] × 0.18 × (Attorney at $423 per hour) = $10,736.

Total ongoing cost reduction: $453,185 reporting + $10,736 recordkeeping = $463,921.

reduce ongoing costs relative to the costs of reporting requirements under the 2013 rule. While a banking entity may incur one-time costs in modifying how it values certain positions for purposes of metrics reporting, the SEC does not expect such systems costs to be significant, particularly if the banking entity is able to use the systems it currently has in place for purposes of metrics reporting to value positions consistent with the final rule. However, the SEC recognizes that some metrics reporters may incur such costs, and they are reflected in the estimate of the one-time metrics switching costs of up to $540,000 for SEC-registered dealers affiliated with a single Group A metrics reporter in section V.F.3.h.i above.

The agencies have received a number of comments on the proposed replacement of the Inventory Turnover metric with the Positions metric and of the Customer-Facing Trade Ratio metric with the Transaction Volumes metrics. With respect to the replacement of Inventory Turnover with Positions, commenters indicated that the Positions metric will involve costly modifications to existing infrastructure and re-scoping of products.[1177] In addition, commenters indicated that Positions metric will provide few valuable insights regarding each desk's overall risk profile and that the granularity will result in false positives.[1178] Commenters also opposed the replacement of the Customer-Facing Trade Ratio with the Transactions Volume metric, arguing that it would create a new metric, require firms to classify inter-affiliate transactions, increase transition and system update costs, and fail to provide the agencies with valuable information enhancing oversight for the purposes of section 13 of the BHC Act.[1179]

The SEC continues to believe that requiring banking entities to provide more granular data in the Positions and Transaction Volumes metrics will not significantly alter the costs associated with the 2013 rule's Inventory Turnover and Customer-Facing Trade Ratio metrics.[1180] The Positions and Transaction Volumes metrics are based on the same underlying data regarding the trading activity of a trading desk as the Inventory Turnover and Customer-Facing Trade Ratio metrics. The SEC expects that banking entities already keep records of these data and have systems in place that collect these data. Moreover, in response to commenter concerns regarding the extra recordkeeping costs related to distinguishing trades across affiliated banking entities from trades within a single banking entity, the final rule adds a category of counterparty for internal transactions that consolidates the two proposed categories (transactions across affiliated banking entities from trades within a single banking entity) into one category (transactions with trading desks and other organizational units). This additional category of information may facilitate better classification of internal transactions, which may assist the SEC in evaluating whether the trading desk's activities are consistent with the requirements of the exemptions for underwriting or market making-related activity.

The SEC remains cognizant of the costs of the amendments on reporters. In the proposal the SEC anticipated that reporting more granular information in the Positions and Transaction Volumes metrics may result in costs of $24,480.[1181] The SEC revises the estimate to $17,280 to reflect updated information about the number of reporters with affiliated SEC-registered dealers affected by the metrics amendments.[1182] In addition, in the proposal, the SEC estimated that modifying the 2013 rule's requirements of the Customer-Facing Trade Ratio to require SEC-regulated banking entities to further categorize trading desk transactions may impose additional systems costs related to tagging internal transactions and maintaining associated records valued at $21,420 for all reporters.[1183] The SEC now revises this estimate to $15,120 to reflect updated information about the number of reporters with affiliated SEC-registered dealers affected by the metrics amendments.[1184]

Importantly, the Positions and Transaction Volumes metrics requirements as amended may reduce costs compared to the reporting requirements under the 2013 rule by limiting the scope of trading desks that must provide the position- and trade-based data that is currently required by the Inventory Turnover and Customer-Facing Trade Ratio metrics. Under the 2013 rule, banking entities are required to calculate and report the Inventory Turnover and the Customer-Facing Trade Ratio metrics for all trading desks engaged in covered trading activity. The final rule would limit the scope of trading desks for which a banking entity would be required to calculate and report the Positions and Transaction Volumes metrics to only those trading desks engaged in market making-related activity or underwriting activity. These burden reductions are captured in the estimates of reporting and recordkeeping burden reductions in section V.F.3.h.i.

Risk Factor Sensitivities, Inventory Aging, and Stress VaR

The final rule eliminates the Risk Factor Sensitivities, Inventory Aging, and Stress VaR metrics of the 2013 rule. As estimated in section V.F.3.h.i, the SEC expects that the metrics amendments, including the elimination of these quantitative metrics requirements, will reduce burdens related to reporting and recordkeeping for Group A entities without adversely affecting the SEC's ability to oversee banking entities for purposes of section 13 of the BHC Act.

The final rule removes the requirement to report Risk Factor Sensitivities metrics, which is expected to reduce burdens related to data manipulation. The SEC understands that reporters may routinely calculate Risk Factor Sensitivities as part of their risk systems. However, the SEC understands that reporters have to routinely summarize large volumes of highly disaggregated Risk Factor Sensitivities from the risk systems for purposes of compliance with the 2013 rule. As discussed in section IV.E.5, the agencies estimate that the removal of Risk Factor Sensitivities may reduce the total volume of data submitted by reporters by more than half.

In addition, the SEC recognizes that one size may not fit all with respect to risk factors. Specifically, different risk factors at various levels of granularity may be relevant for different banking entities, and the Risk Factor Sensitivities may not adequately capture structural differences among the types of risk managed by trading desks in some banking entities.[1185] The SEC also notes that banking entities may already provide information about risk factor sensitivities as part of market risk

[1177] *See, e.g.,* SIFMA and GFMA.

[1178] *Id.*

[1179] *See* IIB; SIFMA and JBA.

[1180] *See, e.g.,* 83 FR at 33541.

[1181] In the Proposing Release, the SEC anticipated that costs associated with the more granular reporting in the Positions and Transaction Volumes metrics will be $8,000 per affiliated group of SEC-regulated banking entities. ($8,000 × 17 reporters × 0.18 SEC-registered banking entity weight) = $24,480.

[1182] $8,000 × 12 reporters × 0.18 SEC-registered banking entity weight = $17,280.

[1183] In that Release, the SEC estimated that the additional costs associated with categorizing transactions under the Transaction Volumes metric will be $7,000 per reporter. ($7,000 × 17 reporters × 0.18 SEC-registered banking entity weight) = $21,420.

[1184] $7,000 × 12 reporters × 0.18 SEC-registered banking entity weight = $15,120.

[1185] *See* SIFMA.

reporting.[1186] As discussed in section IV.E.9.a.i above, the final rule may reduce redundancy in metrics reporting since banking entities would be required to submit one consolidated Internal Limits Information Schedule for the covered trading activity of the entire entity.

The elimination of the Inventory Aging metric in the final rule recognizes the limitations of this metric for SEC's oversight for purposes of section 13 of the BHC Act, the information in the newly required Positions metric, as well as the fact that the notions of inventory and inventory aging are not meaningful indicators of the scale and risk of derivative positions.[1187] The SEC continues to believe that this amendment does not reduce the benefits of metrics reporting, as inventory aging does not enable a clear identification of prohibited proprietary trading or exempt market making, risk-mitigating hedging, or underwriting activities.

The elimination of the Stress VaR metric is expected to reduce burdens related to reporting and recordkeeping for Group A entities, contributing to the estimates of burden reductions in section V.F.3.h.i. The SEC recognizes one commenter's concerns that banking entities may currently face computational challenges, including those related to the determination of the stressed period and dynamic recalibration and that multinational holding companies may use different stress periods for subsidiaries in different jurisdictions.[1188] As discussed above, under the final rule, banking entities would still be required to submit one consolidated Internal Limits Information Schedule for the covered trading activity of the entire entity. The SEC understands that many banking entities do not routinely set Stress VaR limits at the trading desk level but compute Stress VaR at the entity level. Thus, as discussed above, the final rule may alleviate the need for redundant computations and submissions of Stress VaR at the desk level and may reduce the size of electronic submissions. Importantly, the SEC continues to note that eliminating the Stress VaR metric is unlikely to reduce the benefits of metrics reporting, as Stress VaR does not enable the SEC to distinguish between prohibited proprietary trading and permissible market making, risk-mitigating hedging, or underwriting activities of a trading desk.[1189]

Comprehensive Profit and Loss Attribution

The final rule makes two main changes to the Source-of-Revenue Measurements. First, the final rule eliminates the requirement that banking entities calculate and report the volatility of comprehensive profit and loss. Since the volatility of profit and loss can be calculated from other items being reported by the banking entities, the SEC does not believe that this aspect of the final rule would adversely affect the information available for the oversight of entities for the purposes of section 13 of the BHC Act.

Second, the final rule requires banking entities to provide a complete attribution of their profit and loss and, for one or more factors that explain the preponderance of the profit or loss changes due to risk factor changes, banking entities are required to report a unique identification label for the factor and the profit or loss due to the factor change. The SEC recognizes that the Risk Factor Attribution Information Schedule and the new unique identification label reporting requirement may impose additional burdens on reporters. As discussed in section IV.E, the agencies generally expect that the final rule may enable banking entities to leverage compliance with market risk capital programs to meet the final metrics requirements, which may reduce complexity and cost for banking entities and improve the effectiveness of the final rule. The SEC also notes that the final rule also includes an amendment to the trading desk definition, allowing reporters to use the same trading desk and risk factor attribution and risk factor sensitivity hierarchies. At the same time, profit and loss attribution and the identification label may enhance the ability of regulators to connect risk factors that explain a preponderance of the profit or loss changes due to risk factors with a separate Risk Factor Attribution Information Schedule. Thus, these amendments may help enhance the agencies' understanding of the structure of reporters' activity and the nature of their revenue sources.

(3) Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement

As recognized in Appendix A of the 2013 rule, the effectiveness of particular quantitative measurements may differ depending on the profile of a particular trading desk, including the types of instruments traded and trading activities and strategies.[1190] Thus, the additional qualitative information the agencies would collect in the Trading Desk Information and Quantitative Measurements Identifying Information provision may facilitate SEC review and analysis of covered trading activities and reported metrics. For instance, the trading desk description may help the SEC assess the risks associated with a given activity and establish the appropriate frequency and scope of examination of such activity. Having access to such information may allow the agencies to consider the specifics of each trading desk's activities during the reporting period, which may facilitate regulatory oversight.

In addition, under the final rule, banking entities may choose to provide a Narrative Statement that describes any changes in calculation methods used, a description of and reasons for changes in the trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement may include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used. The Narrative Statement may provide banking entities with an opportunity to describe and explain unusual aspects of the data or modifications that may have occurred since the last submission, which may facilitate better evaluation of the reported data.

The SEC has received comments opposing the inclusion of additional descriptive information about metrics, including the Trading Desk Information, Narrative Statement, and Quantitative Measurements Identifying Information, as part of amended metrics reporting requirements.[1191] Specifically, a number of commenters indicated that there are few benefits of such qualitative information for the agencies' ability to oversee registrants for purposes of section 13 of the BHC Act.[1192] In addition, some commenters stated that the requirements are costly and burdensome as they vastly expand the scope of information requested.[1193] With respect to the Narrative Statement, one commenter recognized that banking entities currently provide such additional information voluntarily but indicated that the requirement would impose costs on banking entities that are

[1186] *Id.*

[1187] For example, the value of derivatives fluctuates with the price of an underlying asset and the notional amount of the contract, and derivative contracts are routinely amended and terminated prior to expiry. *See also, e.g.,* GFMA, State Street, Data Boiler.

[1188] *See, e.g.,* Data Boiler.

[1189] *See, e.g.,* Goldman Sachs; FSF and Data Boiler.

[1190] *See* 79 FR 5798.

[1191] *See, e.g.,* Credit Suisse; JBA and SIFMA.

[1192] *See* ABA; CCMR; SIFMA and Credit Suisse.

[1193] *See, e.g.,* Credit Suisse and CCMR.

unnecessary given that the agencies may be able to obtain this information through other supervision.[1194] Another commenter indicated that the proposed amendments significantly expanded the scope of the Narrative Statement requirement relative to current voluntary submissions, and that the Narrative Statement may provide little value to the agencies when assessing data submissions for purposes of compliance with the 2013 rule.[1195]

As discussed above, the SEC continues to believe that the Trading Desk Information and Quantitative Measurements Identifying Information may enhance the efficiency of data review by regulators. Three aspects of the final rule address the cost concerns of commenters regarding the proposed Trading Desk, Narrative Statement, and Quantitative Measurements Identifying Information amendments discussed above. First, the final rule would not require reporters to identify the legal entity used as a booking entity by the trading desk, but instead would require the reporting of a list of agencies receiving the submission of the trading desk and the exemptions or exclusions under which the desk conducts trading activity. Second, the final rule would not require reporters to identify products traded by the desk. Third, under the final rule, the submission of the Narrative Statement would be optional for reporters. The SEC believes that these aspects of the qualitative information amendments would mitigate any new burdens related to these requirements while facilitating oversight by the agencies.

However, the SEC recognizes that several proposed schedules in quantitative measurements identifying information may create reporting burdens. As discussed in section IV.E, the final rule does not require reporting of the risk factor sensitivities information schedule, the limit/sensitivity cross-reference schedule, and the risk-factor sensitivity/attribution cross-reference schedule. However, the final rules would require reporting of Risk Factor Attribution Information Schedules and Internal Limits Information Schedules that includes identification of the corresponding risk factor attribution for certain limits, imposing two new schedule requirements relative to the regulatory baseline under the 2013 rule. However, as discussed above, some reporters may currently use the same limits and risk factors for multiple desks, resulting in duplicative reporting of daily limits by multiple desks for a given reporter. To the extent that these reporters may choose to use the two new schedules to submit a comprehensive list of risk and position limits and risk-factor sensitivities, these schedules may reduce duplicative reporting burdens. The agencies have also received comment that the agencies have alternative tools for monitoring banking entity risk (such as the CCAR process) and that the risk factor attribution schedule does not adequately capture differences between risks managed by different trading desks of a banking entity.[1196] The SEC believes that the descriptions of the Internal Limits Information Schedule and Risk Factor Attribution Information Schedule for certain limits may inform oversight of SEC-regulated banking entities affiliated with reporters with respect to their compliance with the requirements of the final rule.

Moreover, the SEC continues to note that all the SEC-regulated entities that currently report metrics are also currently providing certain elements of the Trading Desk Information to the SEC. The SEC continues to believe that the costs associated with preparing the Narrative Statement will depend on the extent to which a banking entity modifies its calculation methods, makes changes to a trading desk's structure or trading strategies, or otherwise has additional information that it views as relevant for assessing the information reported. Preparation of a Narrative Statement is expected to be more of a manual process involving a written description of pertinent issues. However, all but one SEC reporter already provides a narrative with every submission.

In the proposal, the SEC estimated that the proposed Narrative Statement requirement is expected to result in ongoing personnel and monitoring costs of only $1,980.[1197] The agencies have received comment that this estimate of ongoing costs is a significant underestimate, since reporters will need to revise all of their metrics reporting systems and embark on a new round of systems integration with multiple agencies independently.[1198] The commenter indicated that the exercise is not dissimilar from the initial implementation of the 2013 rule's metrics.[1199] Another commenter supported retaining requirements of the 2013 rule since any metrics amendments would require modifications to measurement tools, involving burdens, testing time, and outsourcing costs of development staff.[1200]

The SEC agrees that the final rule will involve one-time costs to transition their systems and transition their compliance architecture to the amended metrics requirements for Group A entities, which are incorporated in the agencies' estimates in section V.B and in the SEC's analysis in section V.F.3.h.i. The SEC notes that its analysis is specific to SEC regulated banking entities and the estimates only represent a fraction of the compliance costs of holding companies allocated to affiliated SEC-regulated banking entities. The SEC also notes that the $1,980 estimate in the proposal was specific to the Narrative Statement requirement for one reporter, rather than the totality of the burdens imposed on registrants from new metrics requirements; and, under the final rule, the submission of the Narrative Statement is optional. Moreover, the SEC anticipates considerable variation in one-time system transition costs among reporters, depending on the size and complexity of their existing trading activity, the number of trading desks per reporter for the purposes of metrics reporting, the way in which reporters may organize reporting and compliance obligations for the purposes of, for instance, the market risk capital rule, and the complexity of their current systems.

However, recognizing the above comments concerning systems changes that all reporters may have to make for the purposes of reporting of qualitative information, the SEC now estimates that the combined one-time systems costs related to the submission of new qualitative information (including Trading Desk Information, Quantitative Measurements Identifying Information, and the optional Narrative Statement) may be as high as $22,500 for SEC-registered entities affiliated with a single Group A metrics reporter[1201] and

[1194] *See* SIFMA.

[1195] *See* Credit Suisse.

[1196] *See, e.g.,* SIFMA.

[1197] The SEC estimates that costs associated with the proposed Narrative Statement will be $11,000 per affiliated group of SEC-regulated banking entities. ($11,000 × 1 reporter × 0.18) = $1,980.

[1198] *See* SIFMA.

[1199] *Id.*

[1200] *See, e.g.,* JBA.

[1201] In Regulation Crowdfunding, the SEC estimated that intermediaries (whether broker-dealers or funding portals) that already have in place platforms and related systems that will need to tailor their existing platform and systems to comply with the requirements of Regulation Crowdfunding may incur an initial average cost of $250,000. *See* 80 FR 71509. Since the qualitative information requirements in the final rule are considerably more limited than the requirements in Regulation Crowdfunding, the SEC estimates that tailoring existing platforms and systems with respect to the qualitative information requirements for metrics reporters may be half as costly as the

Continued

$270,000 for all SEC-registered entities affiliated with all reporters.[1202] If transitioning reporting systems to meet the requirements of the final rule impose one-time costs and IT burdens comparable with those of the metrics requirements of the 2013 rule,[1203] the compliance costs related to the 2013 rule can be used to estimate potential one-time switching costs for some banking entities. In the proposal, the SEC reported an estimate from a market participant incurring approximately $3 million in costs associated with the buildout of new IT infrastructure and system enhancements.[1204] Using this estimate, the one-time costs related to transitioning metrics reporting to comply with the requirements of the final rule may be as high as $540,000 [1205] for SEC-registered dealers affiliated with a single Group A metrics reporter and as high as $6,480,000 [1206] for all SEC-registered entities affiliated with all reporters.

(4) Time to Report

The agencies are amending the time frame for metrics reporting by requiring quarterly reporting for all reporters and extending the timeline for metrics submissions to 30 days following the end of each calendar quarter. The SEC has received comments supporting a move to quarterly reporting [1207] and an extended reporting timeframe for reporters with more than $50 billion in trading assets and liabilities [1208] and stating that such timeframes account for the scale and complexity of profit and loss reconciliations as well as the internal compliance and governance processes of such banking entities. The SEC also notes that, to the extent that the shorter timeframe for submission may result in later resubmissions to correct errors, the increase in time for some reporters may decrease compliance burdens and make the information collection process more efficient.

As estimated in Table 5 of the economic baseline, this amendment would not affect the reporting schedule of four reporters with between $20 billion and $50 billion in trading assets and liabilities and would provide additional flexibility and time to eight reporters with over $50 billion in trading assets and liabilities. In addition to reductions in compliance burdens, the final rule may also involve greater improvements in the number of banking entities reporting on time and in the quality of submissions. As estimated in Panel A of Table 7, approximately 66% of all records submitted by reporters with over $50 billion in trading assets and liabilities are resubmitted to the SEC at least once. In addition, from Panel B of Table 7, the average delay in initial submissions is approximately 2 days. The SEC notes that in addition to resulting in potentially higher quality submissions with fewer resubmissions, under the final rule the agencies may not receive the information as promptly. However, the SEC will continue to have access to quantitative metrics and related information through the standard examination and review process and existing recordkeeping requirements.

(5) XML Format

The agencies are requiring banking entities to submit the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement in accordance with the XML Schema specified and published on the relevant agency's website.[1209] Under the 2013 rule, the metrics are not required to be reported in a structured format, and banking entities are currently reporting quantitative measurement data electronically. In the proposal, the SEC noted that, on the basis of discussions with metrics reporters, most of these entities indicated a familiarity with XML, and further, several indicated that they use XML internally for other reporting purposes. In addition, banks currently submit quarterly Reports of Condition and Income (''Call Reports'') to the Federal Financial Institutions Examination Council (''FFIEC'') Central Data Repository in eXtensible Business Reporting Language (''XBRL'') format, an XML-based reporting language, so they are generally familiar with the processes and technology for submitting regulatory reports in a structured data format. The SEC believes that familiarity with these practices at the bank level will facilitate the implementation of these practices for SEC registrants. Furthermore, FINRA requires its member broker-dealers to file their FOCUS Reports in a structured format through its eFOCUS system.[1210] The eFOCUS system permits broker-dealers to import the FOCUS Report data into a filing using an Excel, XML, or text file. Therefore, the SEC continues to believe that SEC-regulated dealers covered by the metrics reporting and recordkeeping requirements may have experience applying the XML format to their data.

Reporting metrics and other information in XML allows data to be tagged, which in turn identifies the content of the underlying information. The data then becomes instantly machine readable through the use of standard software. Requiring banking entities to submit the metrics in accordance with the XML Schema would enhance the agencies' ability to process and analyze the data. Once the data is in a structured format, it can be easily organized for viewing, manipulation, and analysis through the use of commonly used software tools and applications. Structured data can allow the agencies to discern patterns from large quantities of information much more easily than unstructured data. The SEC continues to believe that structured data also facilitates the ability to dynamically search, aggregate, and compare information across submissions, whether within a banking entity, across multiple banking entities, or across multiple date ranges. The data supplied in a structured format could help the SEC identify outliers or trends that could warrant further investigation.

Specifying the format in which banking entities must report information may help ensure that the agencies receive consistently comparable information in an efficient manner across banking entities. The costs associated with providing XML data lie in the specialized software or services required to make the submission and the time required to map the required data elements to the requisite taxonomy. In addition to enhanced viewing, manipulation, and analysis, the benefits associated with providing XML data lie in the enhanced validation tools that minimize the likelihood that data are reported with errors. Therefore, subsequent reporting periods may require fewer resources, relative to both initial reporting periods under the final rule and the current reporting process.

In the proposal, the SEC recognized that, as a result of the proposed amendments, banking entities will be

cost estimate in Regulation Crowdfunding. $\$250{,}000 \times 0.5 \times 0.18 = \$22{,}500$.

[1202] $\$22{,}500 \times 12$ reporters = $270,000.

[1203] *See* SIFMA.

[1204] *Id.*

[1205] $3 million × 0.18 × 1 reporter = $540,000.

[1206] $540,000 × 12 reporters = $6,480,000.

[1207] *See, e.g.,* SIFMA.

[1208] *See, e.g.,* Goldman Sachs; Credit Suisse and FSF.

[1209] XML is an open standard, meaning that it is a technological standard that is widely available to the public at no cost. XML is also widely used across the industry.

[1210] For example, FINRA members commonly use FINRA's Web EFT system, which requires that all data be submitted in XML. *See http://www.finra.org/industry/web-crd/web-eft-schema-documentation-and-schema-files. Also see* 81 FR 49499. Information about FINRA's eFOCUS system is available at *http://www.finra.org/industry/focus.*

required to establish and implement systems in accordance with the XML Schema that will result in one-time costs and estimated such costs at an average of $75,000 [1211] per reporter, for an expected aggregate one-time cost of approximately $229,500 for all SEC registrants.[1212]

The agencies received several comments regarding the costs of transitioning to metrics reporting in an XML format. Some commenters indicated that they did not support the amendment as it would increase costs related to switching formats of reporting software and systems and supported the retention of existing (.DAT) format used for submissions but did not provide any quantification for the costs of switching to the .XML format.[1213] Other commenters generally supported metrics reporting in a standardized data format and the proposed transition to XML reporting.[1214] One commenter indicated that the transition to XML reporting of metrics will require significant switching costs and that there will also be ongoing costs because of potential changes to the XML schema or the underlying information to which the XML schema relates over time.[1215] Another commenter supported the XML reporting format and estimated that reporters would incur a one-time switching cost related to equipment, systems, training, and staffing or maintenance of $40,000 per banking entity.[1216]

The SEC continues to estimate that each reporter may incur a one-time switching cost of up to $75,000 but is adjusting the total aggregate reporting costs to reflect an updated count of metrics reporters with affiliated SEC-registered banking entities. As discussed in the economic baseline, using data from March 2018 through March 2019, the SEC estimates that 12 reporters with trading assets and liabilities in excess of $20 billion may be subject to the final metrics reporting amendments, resulting in an aggregate estimate of a one-time switching cost of $162,000 for all SEC registrants.[1217] Moreover, since the final rule involves a single one-time change to the reporting format, the SEC continues to believe that SEC-regulated banking entities will not incur significant ongoing costs from this aspect of the final rule. Moreover, the SEC continues to believe that XML reporting will result in a more efficient submission process, including validation of submissions, and anticipates that some of the implementation costs may be offset over time by these greater efficiencies.

ii. Competition, Efficiency, and Capital Formation

Under the amendments, entities that have between $10 and $20 billion in trading assets and liabilities would incur lower costs of compliance as they would no longer be subject to metrics requirements. To the extent that these compliance burdens may be significant for some entities, and since Group B entities are not subject to any metrics requirements, Group A entities close to the threshold may become more competitive with Group B entities. To the extent that some entities are currently experiencing significant metrics-reporting costs and partially or fully passing them along to customers in the form of reduced willingness to transact or higher costs, the final rule may reduce costs of and increase access to capital. However, estimated reporting and recordkeeping burden savings resulting from the final rule are relatively modest, and the SEC does not anticipate a substantial increase in access to capital as a result of the final rule to metrics reporting requirements.

iii. Alternatives

The agencies could have taken several alternative approaches. First, the agencies could have kept the metrics being reported unchanged, but increased or decreased the trading activity thresholds used to determine metrics recordkeeping and reporting by filers and the frequency of such reporting. For instance, the agencies could have used the $10 billion trading activity threshold as proposed. As shown in Table 2, the SEC estimates that this alternative would affect nine bank-affiliated SEC-registered broker-dealers. The alternative would increase the amount and frequency of quantitative data available for regulatory oversight of banking entities. However, under the alternative, these dealers would be required to keep or report metrics, experiencing higher compliance burdens. Similarly, increasing the recordkeeping and reporting thresholds would reduce the scope of application of the metrics reporting requirement, lowering accompanying recordkeeping and reporting obligations as well as potential oversight and supervision benefits. The SEC continues to recognize that while metrics may be used to flag risks and enhance general supervision, as well as demonstrate prudent risk management, metrics being reported under the 2013 rule do not clearly distinguish proprietary trading from market making or hedging activities.

In addition, the agencies could have eliminated the VaR requirement [1218] or replaced VaR with Expected Shortfall [1219] as a potentially better measure of tail risk of a trading desk or banking entity.[1220] The SEC recognizes that VaR and Expected Shortfall are normally based on firm-wide activity, and some entities may not be routinely using such measures to manage and control risk at the trading desk level. As a result, VaR, or Expected Shortfall limits may not be meaningful at the trading desk level. These alternatives

[1211] These cost estimates were based in part on the SEC's recent estimates of the one-time systems costs associated with the proposed requirement that security-based swap data repositories (SDRs) make transaction-level security-based swap data available to the SEC in Financial products Markup Language (FpML) and Financial Information eXchange Markup Language (FIXML). *See* Establishing the Form and Manner with which Security-Based Swap Data Repositories Must Make Security-Based Swap Data Available to the Commission, Exchange Act Release No. 76624 (Dec. 11, 2015), 80 FR 79757 (Dec. 23, 2015) (SBS Taxonomy rule proposing release). The SBS Taxonomy rule proposing release estimates a one-time cost per SDR of $127,000. Although the substance of reporting associated with the metrics is different from the information collected and made available by SDRs, in the Proposing Release, the SEC stated that similar costs may apply to the implementation of XML for the reporting metrics. In particular, on the basis of its experience with similar structured data reporting requirements in other contexts (*e.g.,* the SBS Taxonomy rule), the SEC expected that systems engineering fixed costs will represent the bulk of the costs related to the XML requirement. Among other things, the proposed SBS Taxonomy rule would require SDRs to make available to the SEC in a specific format (in this case, FpML or FIXML) transaction-level data that they are already required to provide. Similarly, in the Proposing Release, the SEC noted that the proposed metrics amendments would require banking entities to produce in XML metrics reports that they are already required (or will be required) to provide. However, the SEC's estimate was reduced to account for the fact that registered broker-dealers already provide eFOCUS reports to FINRA in XML and, therefore, must have the requisite systems in place. The SEC's cost estimates at proposal included responsibilities for modifications of information technology systems to an attorney, a compliance Manager, a programmer analyst, and a senior business analyst and responsibilities for policies and procedures to an attorney, a compliance Manager, a senior systems analyst, and an operations specialist.

[1212] In the Proposing Release, the SEC computed total costs as follows: $75,000 × 17 reporters × 0.18 entity weight = $229,500.

[1213] *See, e.g.,* JBA and Credit Suisse.

[1214] *See, e.g.,* Goldman Sachs and Data Boiler.

[1215] *See* SIFMA.

[1216] *See* Data Boiler.

[1217] $75,000 × 12 reporters × 0.18 entity weight = $162,000.

[1218] *See, e.g.,* Goldman Sachs.

[1219] Expected Shortfall is an estimate of the expected value of losses beyond a given confidence level and is generally calculated as the area under the probability distribution of asset or portfolio returns in the left tail. For an expected shortfall at the 99 percent confidence level, the measure would capture the area under the probability distribution from the 99th percentile to the 100th percentile. *See* Saunders and Cornett (2014), pp. 458–461.

[1220] *See, e.g.,* Data Boiler.

may reduce the burden of reporting and compliance costs relative to the approach being adopted without necessarily reducing the effectiveness of regulatory oversight by the SEC. In addition, VaR and Expected Shortfall may not be informative about banking entity compliance with section 13 of the BHC Act but may help agencies understand the tail risk of supervised entities as a part of ongoing oversight and supervision.

The agencies could have required all Group A banking entities to report metrics on a monthly basis within 20 days of the end of the calendar month. The SEC believes that this alternative would have two partly offsetting effects relative to the baseline. First, the reporters with more than $50 billion in trading assets and liabilities, which are required to report metrics monthly and within 10 days of the end of each calendar month under the 2013 rule, would, under the alternative, have 20 days after the end of each calendar month to report metrics. As estimated in Table 5 of the economic baseline, this aspect of the alternative would affect eight reporters with SEC-registered affiliated banking entities. Second, reporters with more than $20 billion but less than $50 billion in trading assets and liabilities are required to report metrics on a quarterly basis and have 30 days after the end of reach calendar month to do so under the 2013 rule. Under the alternative, these reporters would be required to report on a monthly basis and would have 10 fewer days to do so, relative to the baseline. As estimated in Table 5, this aspect of the alternative would affect four reporters with SEC-registered affiliated banking entities. Thus, the effects of the alternative on the compliance costs and resubmissions of data, as well on changes to the timeliness of data available to the SEC, would likely to be partly offsetting for these two groups of reporters.

The SEC recognizes that the alternative would increase how promptly the SEC receives data from some SEC-registered banking entities relative to the baseline and the final rule. However, more frequent reporting may also decrease the quality of submissions and the need for resubmissions by some SEC-registered banking entities. In addition, because processes enabling more frequent reporting under tight deadlines may generally be costlier, the alternative would result in even smaller reductions in compliance costs for reporters.

The agencies could have eliminated all quantitative metrics recordkeeping and reporting requirements under Appendix A of the 2013 rule.[1221] Alternatively, the agencies could have eliminated all quantitative metrics except for Risk Management and Source of Revenue Metrics.[1222] The SEC recognizes that these alternatives would reduce the amount of data produced and transmitted to the agencies. Metrics reporting enables regulators to have a more complete picture of risk exposures from trading and profit and loss attribution for supervised entities. However, the metrics reporting regime is costly, and banking entities subject to the 2013 rule and SEC oversight are also subject to other compliance and reporting requirements unrelated to the 2013 rule, as well as the standard examination and review process. It is not clear that metrics are superior to internal quantitative risk measurements or other data (such as metrics in the FOCUS reports) reported by SEC-registered broker-dealers in illustrating risk exposures and profitability of various activities by SEC registrants. As previously noted, metrics—such as VaR, dealer inventory, transaction volume, and profit and loss attribution—do not delineate a prohibited proprietary trade and a permitted market making, underwriting or hedging trade. In addition, reporting at the trading desk level may obscure potential prohibited proprietary trades since a banking entity could attempt to accumulate large proprietary trading exposures by allocating them to a large number of trading desks and comingling these proprietary positions with customer facilitation positions for reporting purposes. For example, as can be seen from Table 6 of the economic baseline, reporters across various trading assets and liabilities thresholds currently report metrics for an average or 38 to 56 trading desks. Moreover, reporters' flexibility in defining the metrics may reduce their comparability. The SEC continues to recognize that metrics do not delineate a prohibited proprietary trade and a permitted market making, underwriting or hedging trade, but they may be used to enhance regulatory oversight. The SEC notes that reporters are already currently subject to a large number of reporting obligations unrelated to section 13 of the BHC Act, such as those under the Market Risk Capital rule and Form FOCUS reporting requirements, providing large volumes of distinct data that can be used to flag risks and enhance general supervision. However, as discussed above, the SEC recognizes that metrics may have value for ongoing oversight, and the final rule tailors and streamlines metrics reporting requirements rather than eliminating all metrics as a whole.

As discussed elsewhere in this supplementary information, the final rule has a compliance date of January 1, 2021, while enabling early voluntary compliance with the final rule (subject to the agencies' completion of necessary technological changes). This approach recognizes the heterogeneity in the existing compliance burdens related to the 2013 rule and in the one-time burdens and time costs that different banking entities may incur as a result of transitioning their compliance programs, while preserving continuity of metrics reporting and agency oversight. The SEC has considered alternative approaches adopting more (or less) delayed compliance dates and disallowing voluntary early compliance with some aspects of the final rule. Such alternatives would provide more (or less) time to transition their compliance programs and adapt reporting systems to the requirements of the final rule. Moreover, as discussed elsewhere in this economic analysis, the SEC continues to believe that the final rule may result in significant burden reductions for some banking entities. Alternatives disallowing early voluntary compliance would delay the benefits of such burden reductions for the most affected banking entities.

G. Congressional Review Act

For the SEC, the Office of Information and Regulatory Affairs, pursuant to the Congressional Review Act (CRA), has designated this rule as a ''major rule'' as defined by 5 U.S.C. 804(2). For the FDIC and OCC, the Office of Information and Regulatory Affairs, pursuant to the CRA, has designated this rule as not a ''major rule.''

List of Subjects

12 CFR Part 44

Banks, Banking, Compensation, Credit, Derivatives, Government securities, Insurance, Investments, National banks, Penalties, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Trusts and trustees.

12 CFR Part 248

Administrative practice and procedure, Banks, Banking, Conflict of interests, Credit, Foreign banking, Government securities, Holding companies, Insurance, Insurance companies, Investments, Penalties, Reporting and recordkeeping requirements, Securities, State

[1221] *See* New England Council.

[1222] *See, e.g.,* New England Council and State Street.

nonmember banks, State savings associations, Trusts and trustees.

12 CFR Part 351

Banks, Banking, Conflicts of interest, Credit, Government securities, Insurance, Insurance companies, Investments, Penalties, Reporting and recordkeeping requirements, Securities, Trusts and trustees.

17 CFR Part 75

Banks, Banking, Compensation, Credit, Derivatives, Federal branches and agencies, Federal savings associations, Government securities, Hedge funds, Insurance, Investments, National banks, Penalties, Proprietary trading, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Swap dealers, Trusts and trustees, Volcker rule.

17 CFR Part 255

Banks, Brokers, Dealers, Investment advisers, Recordkeeping, Reporting, Securities.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons stated in the Common Preamble, the Office of the Comptroller of the Currency amends chapter I of Title 12, Code of Federal Regulations as follows:

PART 44—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 1. The authority citation for part 44 continues to read as follows:

Authority: 7 U.S.C. 27 *et seq.,* 12 U.S.C. 1, 24, 92a, 93a, 161, 1461, 1462a, 1463, 1464, 1467a, 1813(q), 1818, 1851, 3101 3102, 3108, 5412.

Subpart A—Authority and Definitions

■ 2. Section 44.2 is revised to read as follows:

§ 44.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraph (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in § 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Limited trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 44.6(a)(1) and (2) of subpart B) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion; and

(ii) The OCC has not determined pursuant to § 44.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (s)(3) of this section, trading assets and liabilities for purposes of this paragraph (s) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 44.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (s) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 44.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

(ii) For purposes of paragraph (s)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (s)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States, including branches outside the United States that are managed or controlled by a U.S. branch or agency of the foreign banking organization, for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(t) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(u) *Moderate trading assets and liabilities* means, with respect to a banking entity, that the banking entity does not have significant trading assets and liabilities or limited trading assets and liabilities.

(v) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(w) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(x) Qualifying foreign banking organization means a foreign banking organization that qualifies as such under § 211.23(a), (c), or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(y) *SEC* means the Securities and Exchange Commission.

(z) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(aa) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(bb) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(cc) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(dd) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(ee) *Significant trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $20 billion; or

(ii) The OCC has determined pursuant to § 44.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity, other than a banking entity described in paragraph (ee)(3) of this section, trading assets and liabilities for purposes of this paragraph (ee) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 44.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (ee) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 44.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States as well as branches outside the United States that are managed or controlled by a branch or agency of the foreign banking entity operating, located or organized in the United States).

(ii) For purposes of paragraph (ee)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (ee)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(ff) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(gg) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(hh) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ii) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

■ 3. Section 44.3 is amended by:
■ a. Revising paragraphs (b), (d)(3), and (d)(8) and (9);
■ b. Adding paragraphs (d)(10) through (13);
■ c. Redesignating paragraphs (e)(5) through (13) as paragraphs (e)(6) through (14);
■ d. Adding new paragraph (e)(5); and
■ e. Revising newly redesignated paragraphs (e)(11), (12), and (14).

The revisions and additions read as follows:

§ 44.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account.* (1) *Trading account.* Trading account means:

(i) Any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from the purchases or sales of financial instruments described in this paragraph;

(ii) Any account that is used by a banking entity to purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, 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; or

(iii) Any account that is used by a banking entity to purchase or sell one or more financial instruments, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Trading account application for certain banking entities.* (i) A banking entity that is subject to paragraph (b)(1)(ii) of this section in determining the scope of its trading account is not subject to paragraph (b)(1)(i) of this section.

(ii) A banking entity that does not calculate risk-based capital ratios under the market risk capital rule and is not a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk based capital ratios under the market risk capital rule may elect to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph. A banking entity that elects under this section to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph is not required to apply paragraph (b)(1)(i) of this section.

(3) Consistency of account election for certain banking entities. (i) Any election or change to an election under paragraph (b)(2)(ii) of this section must apply to the electing banking entity and all of its wholly owned subsidiaries. The primary financial regulatory agency of a banking entity that is affiliated with but is not a wholly owned subsidiary of such electing banking entity may require that the banking entity be subject to this uniform application requirement if the primary financial regulatory agency determines that it is necessary to prevent evasion of the requirements of this part after notice and opportunity for response as provided in subpart D of this part.

(ii) A banking entity that does not elect under paragraph (b)(2)(ii) of this section to be subject to the trading account definition in (b)(1)(ii) of this section may continue to apply the trading account definition in paragraph (b)(1)(i) of this section for one year from the date on which it becomes, or becomes a consolidated affiliate for regulatory reporting purposes with, a banking entity that calculates risk-based capital ratios under the market risk capital rule.

(4) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed not to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for sixty days or longer and does not transfer substantially all of the risk of the financial instrument within sixty days of the purchase (or sale).

* * * * *

(d) * * *

(3) Any purchase or sale of a security, foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), or cross-currency swap by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular financial instruments to be used for liquidity management purposes, the amount, types, and risks of these financial instruments that are consistent with liquidity management, and the liquidity circumstances in which the particular financial instruments may or must be used;

(ii) Requires that any purchase or sale of financial instruments contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any financial instruments purchased or sold for liquidity management purposes be highly liquid and limited to financial instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any financial instruments purchased or sold for liquidity management purposes, together with any other financial instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under § 44.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in this paragraph (d)(3); and

(vi) Is consistent with the OCC's regulatory requirements regarding liquidity management;

* * * * *

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity;

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the OCC;

(10) Any purchase or sale of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error;

(11) Contemporaneously entering into a customer-driven swap or customer-driven security-based swap and a matched swap or security-based swap if:

(i) The banking entity retains no more than minimal price risk; and

(ii) The banking entity is not a registered dealer, swap dealer, or security-based swap dealer;

(12) Any purchase or sale of one or more financial instruments that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy; or

(13) Any purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form for a banking entity as of January 1, 2020.

(e) * * *

(5) *Cross-currency swap* means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

* * * * *

(11) *Market risk capital rule covered position and trading position* means a financial instrument that meets the criteria to be a covered position and a trading position, as those terms are respectively defined, without regard to whether the financial instrument is reported as a covered position or trading position on any applicable regulatory reporting forms:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(12) *Market risk capital rule* means the market risk capital rule that is contained in 12 CFR part 3, subpart F, with respect to a banking entity for which the OCC is the primary financial regulatory agency, 12 CFR part 217 with respect to a banking entity for which the Board is the primary financial regulatory agency, or 12 CFR part 324 with respect to a banking entity for which the FDIC is the primary financial regulatory agency.

* * * * *

(14) *Trading desk* means a 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 that is:

(i)(A) Structured by the banking entity to implement a well-defined business strategy;

(B) Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies; and

(C) Characterized by a clearly defined unit that:

(*1*) Engages in coordinated trading activity with a unified approach to its key elements;

(*2*) Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;

(*3*) Submits compliance reports and other information as a unit for monitoring by management; and

(*4*) Books its trades together; or

(ii) For a banking entity that calculates risk-based capital ratios under the market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the market risk capital rule.

■ 4. Section 44.4 is revised to read as follows:

§ 44.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 44.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii)(A) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities; and

(B) Reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with paragraph (a)(2)(ii)(A) of this section;

(C) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (a)(2)(iii)(B) and (C) of this section by complying with the requirements set forth in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a distribution of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this section, *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 44.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure, routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The trading desk's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this paragraph (b), including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, in accordance with paragraph (b)(2)(ii) of this section;

(D) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(E) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (b)(2)(iii)(C) and (D) by complying with the requirements set forth in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of this paragraph (b), the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with the methodology described in § 44.2(ee) of this part, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(ii) [Reserved]

(4) *Definition of financial exposure.* For purposes of this section, *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker positions.* For the purposes of this section, *market-maker positions* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

(c) *Rebuttable presumption of compliance*—(1) *Internal limits.* (i) A banking entity shall be presumed to meet the requirement in paragraph (a)(2)(ii)(A) or (b)(2)(ii) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the internal limits for the relevant trading desk as described in paragraph (c)(1)(ii) of this section.

(ii)(A) With respect to underwriting activities conducted pursuant to paragraph (a) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of securities and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's underwriting activities, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held.

(B) With respect to market making-related activities conducted pursuant to paragraph (b) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's market-making related activities, that address the:

(*1*) Amount, types, and risks of its market-maker positions;

(*2*) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) Level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) Period of time a financial instrument may be held.

(2) *Supervisory review and oversight.* The limits described in paragraph (c)(1) of this section shall be subject to supervisory review and oversight by the OCC on an ongoing basis.

(3) *Limit breaches and increases.* (i) With respect to any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, a banking entity shall maintain and make available to the OCC upon request records regarding:

(A) Any limit that is exceeded; and

(B) Any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the OCC.

(ii) In the event of a breach or increase of any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, the presumption described in paragraph (c)(1)(i) of this section shall continue to be available only if the banking entity:

(A) Takes action as promptly as possible after a breach to bring the trading desk into compliance; and

(B) Follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval.

(4) *Rebutting the presumption.* The presumption in paragraph (c)(1)(i) of this section may be rebutted by the OCC if the OCC determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The OCC's rebuttal of the presumption in paragraph (c)(1)(i) must be made in accordance with the notice and response procedures in subpart D of this part.

■ 5. Section 44.5 is amended by revising paragraphs (b) and (c)(1) introductory text and adding paragraph (c)(4) to read as follows:

§ 44.5 Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements.* (1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(1) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(2) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(3) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * *

(1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

■ 6. Section 44.6 is amended by revising paragraph (e)(3), removing paragraphs (e)(4) and (6), and redesignating paragraph (e)(5) as paragraph (e)(4).

The revision reads as follows:

§ 44.6 Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including relevant personnel) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

Subpart C—Covered Funds Activities and Investments

■ 7. Section 44.10 is amended by revising paragraphs (c)(7)(ii) and (c)(8)(i)(A) to read as follows:

§ 44.10 Prohibition on Acquiring or Retaining an Ownership Interest in and Having Certain Relationships with a Covered Fund.

* * * * *

(c) * * *

(7) * * *

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable requirements regarding bank owned life insurance.

(8) * * *

(i) * * *

(A) Loans as defined in § 44.2(t) of subpart A;

* * * * *

■ 8. Section 44.11 is amended by revising paragraph (c) to read as follows:

§ 44.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 44.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 44.4(a) or (b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 44.12(a)(2)(ii) and (iii) and (d).

§ 44.12 [Amended]

■ 9. Section 44.12 is amended by redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

■ 10. Section 44.13 is amended by revising paragraphs (a), (b)(3) and (4), and (c) to read as follows:

§ 44.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 44.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program in accordance with subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising:

(*1*) Out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund; or

(*2*) In connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) With respect to risk-mitigating hedging activity conducted pursuant to paragraph (a)(1)(i) of this section, the compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to paragraph (a)(1)(i) and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) * * *

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of this paragraph (b)(3) to participate in any offer or sale by the covered fund of ownership interests in the covered fund.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

(c) *Permitted covered fund interests and activities by a regulated insurance company.* The prohibition contained in § 44.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws and regulations of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law or regulation described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

■ 11. Section 44.14 is amended by revising paragraph (a)(2)(ii)(B) to read as follows:

§ 44.14 Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the OCC (with a duty to update the certification if the information in the certification materially changes) 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; and

* * * * *

Subpart D—Compliance Program Requirement; Violations

■ 12. Section 44.20 is amended by revising paragraphs (a), (b) introductory text, (c), (d), (e) introductory text, and (f)(2) and adding paragraphs (g), (h), and (i) to read as follows:

§ 44.20 Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) 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 this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities.* With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation.* The CEO of a banking entity that has significant trading assets and liabilities must, based on a review by the CEO of the banking entity, attest in writing to the OCC, each year no later than March 31, that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program required by paragraph (b) of this section in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States.

(d) *Reporting requirements under appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B of this part shall comply with the reporting requirements described in appendix A to this part, if:

(i) The banking entity has significant trading assets and liabilities; or

(ii) The OCC notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A to this part.

(2) *Frequency of reporting:* Unless the OCC notifies the banking entity in writing that it must report on a different basis, a banking entity subject to the Appendix shall report the information required by appendix A to this part for each quarter within 30 days of the end of the quarter.

(e) *Additional documentation for covered funds.* A banking entity with significant trading assets and liabilities shall maintain records that include:

* * * * *

(f) * * *

(2) *Banking entities with moderate trading assets and liabilities.* A banking entity with moderate trading assets and liabilities may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.

(g) Rebuttable presumption of compliance for banking entities with limited trading assets and liabilities—(1) *Rebuttable presumption.* Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities shall be presumed to be compliant with subpart B and subpart C of this part and shall have no obligation to demonstrate compliance with this part on an ongoing basis.

(2) *Rebuttal of presumption.* If upon examination or audit, the OCC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C of this part, the OCC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities. The OCC's rebuttal of the presumption in this paragraph must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the OCC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the OCC determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C of this part, does not warrant a presumption of compliance under paragraph (g) of this section or treatment as a banking entity with moderate trading assets and liabilities, as applicable. The OCC's exercise of this reservation of authority must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(i) *Notice and response procedures*—(1) *Notice.* The OCC will notify the banking entity in writing of any determination requiring notice under this part and will provide an explanation of the determination.

(2) *Response.* The banking entity may respond to any or all items in the notice described in paragraph (i)(1) of this section. The response should include any matters that the banking entity would have the OCC consider in deciding whether to make the determination. The response must be in writing and delivered to the designated OCC official within 30 days after the date on which the banking entity received the notice. The OCC may shorten the time period when, in the opinion of the OCC, the activities or condition of the banking entity so requires, provided that the banking

entity is informed of the time period at the time of notice, or with the consent of the banking entity. In its discretion, the OCC may extend the time period for good cause.

(3) *Waiver.* Failure to respond within 30 days or such other time period as may be specified by the OCC shall constitute a waiver of any objections to the OCC's determination.

(4) *Decision.* The OCC will notify the banking entity of the decision in writing. The notice will include an explanation of the decision.

■ 13. Revise appendix A to part 44 to read as follows:

Appendix A to Part 44—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 44.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the OCC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 44.20.

b. The purpose of this appendix is to assist banking entities and the OCC in:

(1) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(2) Monitoring the banking entity's covered trading activities;

(3) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(4) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 44.4(b) are consistent with the requirements governing permitted market making-related activities;

(5) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to § 44.4, § 44.5, or § 44.6(a) and (b) (*i.e.,* underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(6) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the OCC of such activities; and

(7) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is not intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 44.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 44.4 through 44.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the OCC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 44.2 and 44.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under § 44.4, § 44.5, § 44.6(a), or § 44.6(b). A banking entity may include in its covered trading activity trading conducted under § 44.3(d), § 44.6(c), § 44.6(d), or § 44.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. Quantitative measurements. Each banking entity made subject to this appendix by § 44.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Internal Limits and Usage;

ii. Value-at-Risk;

iii. Comprehensive Profit and Loss Attribution;

iv. Positions; and

v. Transaction Volumes.

2. Trading desk information. Each banking entity made subject to this appendix by § 44.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. Quantitative measurements identifying information. Each banking entity made subject to this appendix by § 44.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. Narrative statement. Each banking entity made subject to this appendix by § 44.20 may provide an optional narrative statement, as further described in this appendix.

5. File identifying information. Each banking entity made subject to this appendix by § 44.20 must provide file identifying information in each submission to the OCC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. Trading Desk Information

1. Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

i. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;

ii. Identification of each type of covered trading activity in which the trading desk is engaged;

iii. Brief description of the general strategy of the trading desk;

v. A list identifying each Agency receiving the submission of the trading desk;

2. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and

3. Currency reported and daily currency conversion rate.

c. Quantitative Measurements Identifying Information

Each banking entity must provide the following information regarding the quantitative measurements:

1. An Internal Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Internal Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, the unit of measurement for the limit, the type of limit, and identification of the corresponding risk factor attribution in the particular case that the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and

2. A Risk Factor Attribution Information Schedule that provides identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement, including the name of the risk factor or other factor, a unique identification label for the risk factor or other factor, a description of the risk factor or other factor, and the risk factor or other factor's change unit.

d. Narrative Statement

Each banking entity made subject to this appendix by § 44.20 may submit in a separate electronic document a Narrative Statement to the OCC with any information the banking entity views as relevant for assessing the information reported. The Narrative Statement may include further description of or changes to calculation methods, identification of material events, description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such changes occurred.

e. Frequency and Method of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the OCC on the reporting schedule established in § 44.20 unless otherwise requested by the OCC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the OCC in accordance with the XML Schema specified and published on the OCC's website.

f. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the OCC pursuant to this appendix and § 44.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the OCC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the OCC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Internal Limits and Usage

i. *Description:* For purposes of this appendix, Internal Limits are 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. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Internal limits and their usage are key compliance and risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in §§ 44.4 and 44.5. A trading desk's risk limits, commonly including a limit on ''Value-at-Risk,'' are useful in the broader context of the trading desk's overall activities, particularly for the market making activities under § 44.4(b) and hedging activity under § 44.5. Accordingly, the limits required under §§ 44.4(b)(2)(iii)(C) and 44.5(b)(1)(i)(A) must meet the applicable requirements under §§ 44.4(b)(2)(iii)(C) and 44.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, "Value-at-Risk" except to the extent the "Value-at-Risk" metric is demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

A. A banking entity must provide the following information for each limit reported pursuant to this quantitative measurement: The unique identification label for the limit reported in the Internal Limits Information Schedule, the limit size (distinguishing between an upper and a lower limit), and the value of usage of the limit.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

2. Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the measurement of the risk of future financial loss in the value of a trading desk's aggregated positions at the ninety-nine percent confidence level over a one-day period, based on current market conditions.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into two categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); and (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions'').

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to (i) changes in the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. For the attribution of comprehensive profit and loss from existing positions to specific risk factors and other factors, a banking entity must provide the following information for the factors that explain the preponderance of the profit or loss changes due to risk factor changes: The unique identification label for the risk factor or other factor listed in the Risk Factor Attribution Information Schedule, and the profit or loss due to the risk factor or other factor change.

C. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

D. The portion of comprehensive profit and loss from existing positions that is not attributed to changes in specific risk factors and other factors must be allocated to a residual category. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

c. Positions and Transaction Volumes Measurements

1. Positions

i. *Description:* For purposes of this appendix, Positions is the value of securities and derivatives positions managed by the trading desk. For purposes of the Positions quantitative measurement, do not include in the Positions calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [1223] A banking

[1223] *See* § 44.2(h), (aa). For example, under this part, a security-based swap is both a ''security'' and a ''derivative.'' For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.

entity must separately report the trading desk's market value of long securities positions, short securities positions, derivatives receivables, and derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 44.4(a) or (b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description:* For purposes of this appendix, Transaction Volumes measures three exclusive categories of covered trading activity conducted by a trading desk. A banking entity is required to report the value and number of security and derivative transactions conducted by the trading desk with: (i) Customers, excluding internal transactions; (ii) non-customers, excluding internal transactions; and (iii) trading desks and other organizational units where the transaction is booked into either the same banking entity or an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives." [1224] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 44.4(a) to conduct underwriting activity is a market participant identified in § 44.4(a)(7), and a customer of a trading desk that relies on § 44.4(b) to conduct market making-related activity is a market participant identified in § 44.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 44.4(a) or (b) to conduct underwriting activity or market-making-related activity, respectively.

Appendix B to Part 44—[Removed]

■ 14. Appendix B to part 44 is removed.

■ 15. Effective January 1. 2020 until December 31, 2020, appendix Z to part 44 is added to read as follows:

Appendix Z to Part 44—Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Alternative Compliance)

Note: The content of this appendix reproduces the regulation implementing Section 13 of the Bank Holding Company Act as of November 13, 2019.

Subpart A—Authority and Definitions

§ 44.1 Authority, purpose, scope, and relationship to other authorities.

(a) *Authority.* This part is issued by the OCC under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851).

(b) *Purpose.* Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and on investments in or relationships with covered funds by certain banking entities, including national banks, Federal branches and agencies of foreign banks, Federal savings associations, and certain subsidiaries thereof. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and on investments in or relationships with covered funds, and explaining the statute's requirements.

(c) *Scope.* This part implements section 13 of the Bank Holding Company Act with respect to banking entities for which the OCC is authorized to issue regulations under section 13(b)(2) of the Bank Holding Company Act (12 U.S.C. 1851(b)(2)) and take actions under section 13(e) of that Act (12 U.S.C. 1851(e)). These include national banks, Federal branches and Federal agencies of foreign banks, Federal savings associations, Federal savings banks, and any of their respective subsidiaries (except a subsidiary for which there is a different primary financial regulatory agency, as that term is defined in this part), but do not include such entities to the extent they are not within the definition of banking entity in § 44.2(c).

(d) *Relationship to other authorities.* Except as otherwise provided under section 13 of the Bank Holding Company Act or this part, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of the Bank Holding Company Act and this part shall apply to the activities and investments of a banking entity identified in paragraph (c) of this section, even if such activities and investments are authorized for the banking entity under other applicable provisions of law.

(e) *Preservation of authority.* Nothing in this part limits in any way the authority of the OCC to impose on a banking entity identified in paragraph (c) of this section additional requirements or restrictions with respect to any activity, investment, or relationship covered under section 13 of the Bank Holding Company Act or this part, or additional penalties for violation of this part provided under any other applicable provision of law

§ 44.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded

[1224] *See* § 44.2(h), (aa).

commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution,* unless otherwise indicated, has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(t) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(u) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(v) *Qualifying foreign banking organization* means a foreign banking organization that qualifies as such under section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(w) *SEC* means the Securities and Exchange Commission.

(x) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(y) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(z) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(aa) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(bb) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(cc) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(dd) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ee) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ff) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

§ 44.3 Prohibition on proprietary trading.

(a) *Prohibition.* Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. *Proprietary trading* means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

(b) *Definition of trading account.* (1) Trading account means any account that is used by a banking entity to:

(i) Purchase or sell one or more financial instruments principally for the purpose of:

(A) Short-term resale;

(B) Benefitting from actual or expected short-term price movements;

(C) Realizing short-term arbitrage profits; or

(D) Hedging one or more positions resulting from the purchases or sales of financial instruments described in paragraphs (b)(1)(i)(A), (B), or (C) of this section;

(ii) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(iii) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale), unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section.

(c) *Financial instrument.* (1) *Financial instrument* means:

(i) A security, including an option on a security;

(ii) A derivative, including an option on a derivative; or

(iii) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(2) A financial instrument does not include:

(i) A loan;

(ii) A commodity that is not:

(A) An excluded commodity (other than foreign exchange or currency);

(B) A derivative;

(C) A contract of sale of a commodity for future delivery; or

(D) An option on a contract of sale of a commodity for future delivery; or

(iii) Foreign exchange or currency.

(d) *Proprietary trading.* Proprietary trading does not include:

(1) Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(2) Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(3) Any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular securities to be used for liquidity management purposes, the amount, types, and risks of these securities that are consistent with liquidity management, and the liquidity circumstances in which the particular securities may or must be used;

(ii) Requires that any purchase or sale of securities contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any securities purchased or sold for liquidity management purposes be highly liquid and limited to securities the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any securities purchased or sold for liquidity management purposes, together with any other instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of securities that are not permitted under §§ 44.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (d)(3) of this section; and

(vi) Is consistent with the OCC's supervisory requirements, guidance, and expectations regarding liquidity management;

(4) Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments;

(5) Any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(6) Any purchase or sale of one or more financial instruments by a banking entity, so long as:

(i) The purchase (or sale) satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or

(ii) The purchase (or sale) satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding;

(7) Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian;

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United

States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity; or

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the OCC.

(e) *Definition of other terms related to proprietary trading.* For purposes of this subpart:

(1) *Anonymous* means that each party to a purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale.

(2) *Clearing agency* has the same meaning as in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(3) *Commodity* has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(4) *Contract of sale of a commodity for future delivery* means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27))).

(5) Derivatives clearing organization means:

(i) A derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1);

(ii) A derivatives clearing organization that, pursuant to CFTC regulation, is exempt from the registration requirements under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1); or

(iii) A foreign derivatives clearing organization that, pursuant to CFTC regulation, is permitted to clear for a foreign board of trade that is registered with the CFTC.

(6) *Exchange,* unless the context otherwise requires, means any designated contract market, swap execution facility, or foreign board of trade registered with the CFTC, or, for purposes of securities or security-based swaps, an exchange, as defined under section 3(a)(1) of the Exchange Act (15 U.S.C. 78c(a)(1)), or security-based swap execution facility, as defined under section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)).

(7) *Excluded clearing activities* means:

(i) With respect to customer transactions cleared on a derivatives clearing organization, a clearing agency, or a designated financial market utility, any purchase or sale necessary to correct trading errors made by or on behalf of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(ii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a designated financial market utility; and

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

(8) Designated financial market utility has the same meaning as in section 803(4) of the Dodd-Frank Act (12 U.S.C. 5462(4)).

(9) *Issuer* has the same meaning as in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(10) *Market risk capital rule covered position and trading position* means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(11) *Market risk capital rule* means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

(12) *Municipal security* means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

(13) *Trading desk* means 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.

§ 44.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 44.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held;

(C) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(D) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

(iv) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a *distribution* of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this paragraph (a), *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 44.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on:

(A) The liquidity, maturity, and depth of the market for the relevant types of financial instrument(s); and

(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section, on:

(*1*) The amount, types, and risks of its market-maker inventory;

(*2*) The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) The level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) The period of time a financial instrument may be held;

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of this paragraph (b), and independent review of such demonstrable analysis and approval;

(iv) To the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 44.20(d)(1) of subpart D, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(4) Definition of financial exposure. For purposes of this paragraph (b), *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker inventory.* For the purposes of this paragraph (b), *market-maker inventory* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

§ 44.5 Permitted risk-mitigating hedging activities.

(a) *Permitted risk-mitigating hedging activities.* The prohibition contained in § 44.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(1) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(i) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(ii) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(iii) The conduct of analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged;

(2) The risk-mitigating hedging activity:

(i) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(ii) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(iii) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(iv) Is subject to continuing review, monitoring and management by the banking entity that:

(A) Is consistent with the written hedging policies and procedures required under paragraph (b)(1) of this section;

(B) Is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(C) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading; and

(3) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(c) *Documentation requirement*—(1) A banking entity must comply with the requirements of paragraphs (c)(2) and (3) of this section with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

(i) Not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce;

(ii) Established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but that is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures established under paragraph (b)(1) of this section or under § 44.4(b)(2)(iii)(B) of this subpart as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or

(iii) Established to hedge aggregated positions across two or more trading desks.

(2) In connection with any purchase or sale identified in paragraph (c)(1) of this section, a banking entity must, at a minimum, and contemporaneously with the purchase or sale, document:

(i) The specific, identifiable risk(s) of the identified positions, contracts, or other holdings of the banking entity that the purchase or sale is designed to reduce;

(ii) The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and

(iii) The trading desk or other business unit that is establishing and responsible for the hedge.

(3) A banking entity must create and retain records sufficient to demonstrate compliance with the requirements of this paragraph (c) for a period that is no less than five years in a form that allows the banking entity to promptly produce such records to the OCC on request, or such longer period as required under other law or this part.

§ 44.6 Other permitted proprietary trading activities.

(a) *Permitted trading in domestic government obligations.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale by a banking entity of a financial instrument that is:

(1) An obligation of, or issued or guaranteed by, the United States;

(2) An obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*);

(3) An obligation of any State or any political subdivision thereof, including any municipal security; or

(4) An obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(b) *Permitted trading in foreign government obligations*—(1) *Affiliates of foreign banking entities in the United States.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as:

(i) The banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in paragraph (b)(1)(i) of this section is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The purchase or sale as principal is not made by an insured depository institution.

(2) *Foreign affiliates of a U.S. banking entity.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as:

(i) The foreign entity is a foreign bank, as defined in section 211.2(j) of the Board's Regulation K (12 CFR 211.2(j)), or is regulated by the foreign sovereign as a securities dealer;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

(c) *Permitted trading on behalf of customers*—(1) *Fiduciary transactions.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as trustee or in a similar fiduciary capacity, so long as:

(i) The transaction is conducted for the account of, or on behalf of, a customer; and

(ii) The banking entity does not have or retain beneficial ownership of the financial instruments.

(2) *Riskless principal transactions.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(d) *Permitted trading by a regulated insurance company.* The prohibition contained in § 44.3(a) does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if:

(1) The insurance company or its affiliate purchases or sells the financial instruments solely for:

(i) The general account of the insurance company; or

(ii) A separate account established by the insurance company;

(2) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (d)(2) of this

section is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

(e) *Permitted trading activities of foreign banking entities.* (1) The prohibition contained in § 44.3(a) does not apply to the purchase or sale of financial instruments by a banking entity if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State;

(ii) The purchase or sale by the banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale meets the requirements of paragraph (e)(3) of this section.

(2) A purchase or sale of financial instruments by a banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (e)(1)(ii) of this section only if:

(i) The purchase or sale is conducted in accordance with the requirements of paragraph (e) of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of any State and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State;

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;

(iv) 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 the laws of the United States or of any State; and

(v) The purchase or sale is not conducted with or through any U.S. entity, other than:

(A) A purchase or sale with the foreign operations of a U.S. entity if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;

(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.

(4) For purposes of this paragraph (e), a U.S. entity is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this paragraph (e), a U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(6) For purposes of this paragraph (e), *unaffiliated market intermediary* means an unaffiliated entity, acting as an intermediary, that is:

(i) A broker or dealer registered with the SEC under section 15 of the Exchange Act or exempt from registration or excluded from regulation as such;

(ii) A swap dealer registered with the CFTC under section 4s of the Commodity Exchange Act or exempt from registration or excluded from regulation as such;

(iii) A security-based swap dealer registered with the SEC under section 15F of the Exchange Act or exempt from registration or excluded from regulation as such; or

(iv) A futures commission merchant registered with the CFTC under section 4f of the Commodity Exchange Act or exempt from registration or excluded from regulation as such.

§ 44.7 Limitations on permitted proprietary trading activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 44.4 through 44.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§§ 44.8–44.9 [Reserved]

Subpart C—Covered Funds Activities and Investments

§ 44.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) *Prohibition.* (1) Except as otherwise provided in this subpart, a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(2) Paragraph (a)(1) of this section does not include acquiring or retaining an ownership interest in a covered fund by a banking entity:

(i) Acting solely as agent, broker, or custodian, so long as;

(A) The activity is conducted for the account of, or on behalf of, a customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest;

(ii) Through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof) that is established and administered in accordance with the law of the United States or a foreign sovereign, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);

(iii) In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event may the banking entity retain such ownership interest for longer than such period permitted by the OCC; or

(iv) On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as:

(A) The activity is conducted for the account of, or on behalf of, the customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest.

(b) *Definition of covered fund.* (1) Except as provided in paragraph (c) of this section, covered fund means:

(i) An issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), *but for* section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a–3(c)(1) or (7));

(ii) Any commodity pool under section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10)) for which:

(A) The commodity pool operator has claimed an exemption under 17 CFR 4.7; or

(B)(*1*) A commodity pool operator is registered with the CFTC as a commodity pool operator in connection with the operation of the commodity pool;

(*2*) Substantially all participation units of the commodity pool are owned by qualified eligible persons under 17 CFR 4.7(a)(2) and (3); and

(*3*) Participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons under 17 CFR 4.7(a)(2) and (3); or

(iii) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, an entity that:

(A) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(B) Is, or holds 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; and

(C)(*1*) Has as its sponsor that banking entity (or an affiliate thereof); or

(*2*) Has issued an ownership interest that is owned directly or indirectly by that banking entity (or an affiliate thereof).

(2) An issuer shall not be deemed to be a covered fund under paragraph (b)(1)(iii) of this section if, were the issuer subject to U.S. securities laws, the issuer could rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act.

(3) For purposes of paragraph (b)(1)(iii) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(c) Notwithstanding paragraph (b) of this section, unless the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine otherwise, a covered fund does not include:

(1) *Foreign public funds.* (i) Subject to paragraphs (ii) and (iii) below, an issuer that:

(A) Is organized or established outside of the United States;

(B) Is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and

(C) Sells ownership interests predominantly through one or more public offerings outside of the United States.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and employees of such entities.

(iii) For purposes of paragraph (c)(1)(i)(C) of this section, the term "public offering" means a distribution (as defined in § 44.4(a)(3) of subpart B) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(B) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(C) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

(2) *Wholly-owned subsidiaries.* An entity, all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate thereof), except that:

(i) Up to five percent of the entity's outstanding ownership interests, less any amounts outstanding under paragraph (c)(2)(ii) of this section, may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and

(ii) Up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(3) *Joint ventures.* A joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, provided that the joint venture:

(i) Is comprised of no more than 10 unaffiliated co-venturers;

(ii) 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

(iii) 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.

(4) *Acquisition vehicles.* An issuer:

(i) Formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction; and

(ii) That exists only for such period as necessary to effectuate the transaction.

(5) *Foreign pension or retirement funds.* A plan, fund, or program providing pension, retirement, or similar benefits that is:

(i) Organized and administered outside the United States;

(ii) A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and

(iii) Established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.

(6) *Insurance company separate accounts.* A separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses.

(7) *Bank owned life insurance.* A separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is beneficiary, provided that no banking entity that purchases the policy:

(i) Controls the investment decisions regarding the underlying assets or holdings of the separate account; or

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank owned life insurance.

(8) Loan securitizations—(i) *Scope.* An issuing entity for asset-backed securities that satisfies all the conditions of this paragraph (c)(8) and the assets or holdings of which are comprised solely of:

(A) Loans as defined in § 44.2(s) of subpart A;

(B) 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 paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(ii) *Impermissible assets.* For purposes of this paragraph (c)(8), the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraph (c)(8)(iii) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities.* Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives.* The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivative directly relate to the loans, the asset-backed securities, or the contractual rights of other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates.* The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in this paragraph (c)(8);

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under this paragraph (c)(8) and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

(9) *Qualifying asset-backed commercial paper conduits.* (i) An issuing entity for asset-backed commercial paper that satisfies all of the following requirements:

(A) The asset-backed commercial paper conduit holds only:

(*1*) Loans and other assets permissible for a loan securitization under paragraph (c)(8)(i) of this section; and

(*2*) Asset-backed securities supported solely by assets that are permissible for loan securitizations under paragraph (c)(8)(i) of this section and acquired by the asset-backed commercial paper conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or directly from an underwriter in the distribution of the asset-backed securities;

(B) The asset-backed commercial paper conduit issues only asset-backed securities, comprised of a residual interest and securities with a legal maturity of 397 days or less; and

(C) A regulated liquidity provider has entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding asset-backed securities issued by the asset-backed commercial paper conduit (other than any residual interest) in the event that funds are required to redeem maturing asset-backed securities.

(ii) For purposes of this paragraph (c)(9), a regulated liquidity provider means:

(A) A depository institution, as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(B) A bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a subsidiary thereof;

(C) A savings and loan holding company, as defined in section 10a of the Home Owners' Loan Act (12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), or a subsidiary thereof;

(D) A foreign bank whose home country supervisor, as defined in § 211.21(q) of the Board's Regulation K (12 CFR 211.21(q)), has adopted capital standards consistent with the Capital Accord for the Basel Committee on banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(E) The United States or a foreign sovereign.

(10) *Qualifying covered bonds*—(i) *Scope.* An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are comprised solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

(ii) *Covered bond.* For purposes of this paragraph (c)(10), a covered bond means:

(A) A debt obligation issued by an entity that meets the definition of foreign banking organization, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section; or

(B) A debt obligation of an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section, provided that the payment obligations are fully and unconditionally guaranteed by an entity that meets the definition of foreign banking organization and the entity is a wholly-owned subsidiary, as defined in paragraph (c)(2) of this section, of such foreign banking organization.

(11) *SBICs and public welfare investment funds.* An issuer:

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked; or

(ii) The business of which is to make investments that are:

(A) Designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(12) *Registered investment companies and excluded entities.* An issuer:

(i) 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 as described in § 44.20(e)(3) of subpart D and that complies with the requirements of section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a–18);

(ii) That may rely on an exclusion or exemption from the definition of "investment company" under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act; or

(iii) That has elected to be regulated as a business development company 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 business development company as described in § 44.20(e)(3) of subpart D and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a–60).

(13) *Issuers in conjunction with the FDIC's receivership or conservatorship operations.* An issuer that is an entity formed by or on behalf of the FDIC for the purpose of facilitating the disposal of assets acquired in the FDIC's capacity as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(14) *Other excluded issuers.* (i) Any issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act.

(ii) A determination made under paragraph (c)(14)(i) of this section will be promptly made public.

(d) *Definition of other terms related to covered funds.* For purposes of this subpart:

(1) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the OCC determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(2) *Asset-backed security* has the meaning specified in Section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)).

(3) *Director* has the same meaning as provided in section 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

(4) *Issuer* has the same meaning as in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(22)).

(5) *Issuing entity* means with respect to asset-backed securities the special purpose vehicle that owns or holds the pool assets underlying asset-backed securities and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

(6) *Ownership interest*—(i) *Ownership interest* means any equity, partnership, or other similar interest. An ''other similar interest'' means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs (d)(6)(i)(A) through (F) of this section.

(ii) *Ownership interest* does not include: *Restricted profit interest.* An interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(A) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(B) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(C) Any amounts invested in the covered fund, including any amounts paid by the entity (or employee or former employee thereof) in connection with obtaining the restricted profit interest, are within the limits of § 44.12 of this subpart; and

(D) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

(7) *Prime brokerage transaction* means 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.

(8) Resident of the United States means a person that is a ''U.S. person'' as defined in rule 902(k) of the SEC's Regulation S (17 CFR 230.902(k)).

(9) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name, except as permitted under § 44.11(a)(6).

(10) *Trustee.* (i) For purposes of paragraph (d)(9) of this section and § 44.11 of subpart C, a trustee does not include:

(A) A trustee that does not exercise investment discretion with respect to a covered fund, including a trustee that is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)); or

(B) A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to those described in paragraph (d)(10)(i)(A) of this section;

(ii) Any entity that directs a person described in paragraph (d)(10)(i) of this section, or that possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee, shall be considered to be a trustee of such covered fund.

§ 44.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

(a) *Organizing and offering a covered fund in general.* Notwithstanding § 44.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund in connection with, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, only if:

(1) The banking entity (or an affiliate thereof) provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services;

(2) The covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such

services of the banking entity (or an affiliate thereof), pursuant to a written plan or similar documentation outlining how the banking entity or such affiliate intends to provide advisory or similar services to its customers through organizing and offering such fund;

(3) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under § 44.12 of this subpart;

(4) The banking entity and its affiliates comply with the requirements of § 44.14 of this subpart;

(5) The banking entity and its affiliates do 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;

(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof) except that a covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

(A) The investment adviser is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(B) The investment adviser does not share the same name or a variation of the same name as an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(ii) Does not use the word ''bank'' in its name;

(7) No director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity or such affiliate who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

(8) The banking entity:

(i) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(A) That ''any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity] or its affiliates; therefore, [the banking entity's] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity] and any affiliate in its capacity as investor in the [covered fund] or as beneficiary of a restricted profit interest held by [the banking entity] or any affiliate'';

(B) That such investor should read the fund offering documents before investing in the covered fund;

(C) That the ''ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity'' (unless that happens to be the case); and

(D) The role of the banking entity and its affiliates and employees in sponsoring or providing any services to the covered fund; and

(ii) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates.

(b) *Organizing and offering an issuing entity of asset-backed securities.* (1) Notwithstanding § 44.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuing entity of asset-backed securities in connection with, directly or indirectly, organizing and offering that issuing entity, so long as the banking entity and its affiliates comply with all of the requirements of paragraph (a)(3) through (8) of this section.

(2) For purposes of this paragraph (b), organizing and offering a covered fund that is an issuing entity of asset-backed securities means acting as the securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)) of the issuing entity, or acquiring or retaining an ownership interest in the issuing entity as required by section 15G of that Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder.

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 44.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 44.4(a) or § 44.4(b) of subpart B, respectively;

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section; or, directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 44.12(a)(2)(ii) and § 44.12(d) of this subpart; and

(3) With respect to any banking entity, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under § 44.11 of this subpart, including all covered funds in which the banking entity holds an ownership interest in connection with underwriting and market making related activities permitted under this paragraph (c), are included in the calculation of all ownership interests under § 44.12(a)(2)(iii) and § 44.12(d) of this subpart.

§ 44.12 Permitted investment in a covered fund.

(a) Authority and limitations on permitted investments in covered funds. (1) Notwithstanding the prohibition contained in § 44.10(a) of this subpart, a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity or an affiliate thereof organizes and offers pursuant to § 44.11, for the purposes of:

(i) *Establishment.* Establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, subject to the limits contained in paragraphs (a)(2)(i) and (iii) of this section; or

(ii) *De minimis investment.* Making and retaining an investment in the covered fund subject to the limits contained in paragraphs (a)(2)(ii) and (iii) of this section.

(2) *Investment limits*—(i) *Seeding period.* With respect to an investment in any covered fund made or held pursuant to paragraph (a)(1)(i) of this section, the banking entity and its affiliates:

(A) Must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) Must, no later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section), conform its ownership interest in the covered fund to the limits in paragraph (a)(2)(ii) of this section;

(ii) *Per-fund limits.* (A) Except as provided in paragraph (a)(2)(ii)(B) of this section, an investment by a banking entity and its affiliates in any covered fund made or held pursuant to paragraph (a)(1)(ii) of this section may not exceed 3 percent of the total number or value of the outstanding ownership interests of the fund.

(B) An investment by a banking entity and its affiliates in a covered fund that is an issuing entity of asset-backed securities may not exceed 3 percent of the total fair market value of the ownership interests of the fund measured in accordance with paragraph (b)(3) of this section, unless a greater percentage is retained by the banking entity and its affiliates in compliance with the requirements of section 15G of the Exchange Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the amount, number, or value of ownership interests of the fund required under section 15G of the Exchange Act and the implementing regulations issued thereunder.

(iii) *Aggregate limit.* The aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired or retained under this section may not exceed 3 percent of the tier 1 capital of the banking entity, as provided under paragraph (c) of this section, and shall be calculated as of the last day of each calendar quarter.

(iv) *Date of establishment.* For purposes of this section, the date of establishment of a covered fund shall be:

(A) *In general.* The date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund;

(B) *Issuing entities of asset-backed securities.* In the case of an issuing entity of asset-backed securities, the date on which the assets are initially transferred into the issuing entity of asset-backed securities.

(b) *Rules of construction*—(1) *Attribution of ownership interests to a covered banking entity.* (i) For purposes of paragraph (a)(2) of this section, the amount and value of a banking entity's permitted investment in any single covered fund shall include any ownership interest held under § 44.12 directly by the banking entity, including any affiliate of the banking entity.

(ii) Treatment of registered investment companies, SEC-regulated business development companies and foreign public funds. For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies or foreign public fund as described in § 44.10(c)(1) of this subpart will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

(iii) *Covered funds.* For purposes of paragraph (b)(1)(i) of this section, a covered fund will not be considered to be an affiliate of a banking entity so long as the covered fund is held in compliance with the requirements of this subpart.

(iv) Treatment of employee and director investments financed by the banking entity. For purposes of paragraph (b)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires an ownership interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(2) *Calculation of permitted ownership interests in a single covered fund.* Except as provided in paragraph (b)(3) or (4), for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(A) of this section:

(i) The aggregate number of the outstanding ownership interests held by the banking entity shall be the total number of ownership interests held under this section by the banking entity in a covered fund divided by the total number of ownership interests held by all entities in that covered fund, as of the last day of each calendar quarter (both measured without regard to committed funds not yet called for investment);

(ii) The aggregate value of the outstanding ownership interests held by the banking entity shall be the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity, divided by the value of all investments in and capital contributions made to that covered fund by all entities, as of the last day of each calendar quarter (all measured without regard to committed funds not yet called for investment). If fair market value cannot be determined, then the value shall be the historical cost basis of all investments in and contributions made by the banking entity to the covered fund;

(iii) For purposes of the calculation under paragraph (b)(2)(ii) of this section, once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards.

(3) Issuing entities of asset-backed securities. In the case of an ownership interest in an issuing entity of asset-backed securities, for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(B) of this section:

(i) For securitizations subject to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11), the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder; or

(ii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the calculations shall be made as of the date of establishment as defined in paragraph (a)(2)(iv)(B) of this section or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund, and thereafter only upon the date on which additional securities of the issuing entity of asset-backed securities are priced for purposes of the sales of ownership interests to unaffiliated investors.

(iii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

(iv) For purposes of the calculation under paragraph (b)(3)(iii) of this section, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards.

(4) *Multi-tier fund investments*—(i) *Master-feeder fund investments.* If the principal investment strategy of a covered fund (the ''feeder fund'') is to invest substantially all of its assets in another single covered fund (the ''master fund''), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest of the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments.* If a banking entity organizes and offers a covered fund pursuant to § 44.11 of this subpart for the purpose of investing in other covered funds (a ''fund of funds'') and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest of the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(c) *Aggregate permitted investments in all covered funds.* (1) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 44.10(d)(6)(ii) of this subpart), on a historical cost basis.

(2) *Calculation of tier 1 capital.* For purposes of paragraph (a)(2)(iii) of this section:

(i) *Entities that are required to hold and report tier 1 capital.* If a banking entity is required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be equal to the amount of tier 1 capital of the banking entity as of the last day of the most recent calendar quarter, as reported to its primary financial regulatory agency; and

(ii) If a banking entity is not required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, be equal to the amount of tier 1 capital reported by such controlling depository institution in the manner described in paragraph (c)(2)(i) of this section;

(B) In the case of a banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(*1*) *Bank holding company subsidiaries.* If the banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, be equal to the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital in the manner described in paragraph (c)(2)(i) of this section; and

(2) Other holding companies and any subsidiary or affiliate thereof. If the banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, be equal to the total amount of shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(iii) *Treatment of foreign banking entities*—(A) *Foreign banking entities.* Except as provided in paragraph (c)(2)(iii)(B) of this section, with respect to a banking entity that is not itself, and is not controlled directly or indirectly by, a banking entity that is located or organized under the laws of the United States or of any State, the tier 1 capital of the banking entity shall be the consolidated tier 1 capital of the entity as calculated under applicable home country standards.

(B) *U.S. affiliates of foreign banking entities.* With respect to a banking entity that is located or organized under the laws of the United States or of any State and is controlled by a foreign banking entity identified under paragraph (c)(2)(iii)(A) of this section, the banking entity's tier 1 capital shall be as calculated under paragraphs (c)(2)(i) or (ii) of this section.

(d) *Capital treatment for a permitted investment in a covered fund.* For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 44.10(d)(6)(ii) of subpart C), on a historical cost basis, plus any earnings received; and

(2) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (b)(3) of this section (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 44.10(d)(6)(ii) of subpart C), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(e) *Extension of time to divest an ownership interest.* (1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(2) *Factors governing Board determinations.* In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;

(v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;

(vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;

(vi) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;

(viii) Market conditions; and

(ix) Any other factor that the Board believes appropriate.

(3) *Authority to impose restrictions on activities or investment during any extension period.* The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(4) *Consultation.* In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

§ 44.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 44.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund.

(2) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks arising in connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) The compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to this paragraph and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) *Certain permitted covered fund activities and investments outside of the United States.* (1) The prohibition contained in § 44.10(a) of this subpart does not apply to the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a banking entity only if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in the covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity or investment occurs solely outside of the United States.

(2) An activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (b)(1)(ii) of this section only if:

(i) The activity or investment is conducted in accordance with the requirements of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of one or more States and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(*1*) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(*2*) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is sold or has been sold pursuant to an offering that does not target residents of the United States.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State;

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and

(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this section, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States; however, a foreign bank of which that branch, agency, or subsidiary is a part is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 44.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

§ 44.14 Limitations on relationships with a covered fund.

(a) Relationships with a covered fund. (1) Except as provided for in paragraph (a)(2) of this section, no 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 § 44.11 of this subpart, or that continues to hold an ownership interest in accordance with § 44.11(b) of this subpart, and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of § 44.11, § 44.12, or § 44.13 of this subpart; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate thereof) has taken an ownership interest, if:

(A) The banking entity is in compliance with each of the limitations set forth in § 44.11 of this subpart with respect to a covered fund organized and offered by such banking entity (or an affiliate thereof);

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually to the OCC (with a duty to update the certification if the information in the certification materially changes) 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; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

(b) *Restrictions on transactions with covered funds.* A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § 44.11 of this subpart, or that continues to hold an ownership interest in accordance with § 44.11(b) of this subpart, shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1), as if such banking entity were a member bank and such covered fund were an affiliate thereof.

(c) *Restrictions on prime brokerage transactions.* A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1) as if the counterparty were an affiliate of the banking entity.

§ 44.15 Other limitations on permitted covered fund activities and investments.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 44.11 through 44.13 of this subpart if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§ 44.16 Ownership of interests in and sponsorship of issuers of certain collateralized debt obligations backed by trust-preferred securities.

(a) The prohibition contained in § 44.10(a)(1) does not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer if:

(1) The issuer was established, and the interest was issued, before May 19, 2010;

(2) The banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral; and

(3) The banking entity acquired such interest on or before December 10, 2013 (or acquired such interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before December 10, 2013).

(b) For purposes of this § 44.16, *Qualifying TruPS Collateral* shall mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument, had total consolidated assets of less than $15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company.

(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 §§ 44.4 and 44.11.

(d) Without limiting the applicability of paragraph (a) of this section, the Board, the FDIC and the OCC will make public a non-exclusive list of issuers that meet the requirements of paragraph (a). A banking entity may rely on the list published by the Board, the FDIC and the OCC.

§§ 44.17–44.19 [Reserved]

Subpart D—Compliance Program Requirement; Violations

§ 44.20 Program for compliance; reporting.

(a) *Program requirement.* 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 this part. The terms, scope and detail of the compliance program shall be appropriate for the types, size, scope and complexity of activities and business structure of the banking entity.

(b) *Contents of compliance program.* Except as provided in paragraph (f) of this section, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities subject to subpart B (including those permitted under §§ 44.3 to 44.6 of subpart B), including setting, monitoring and managing required limits set out in §§ 44.4 and 44.5, and activities and investments with respect to a covered fund subject to subpart C (including those permitted under §§ 44.11 through 44.14 of subpart C) conducted by the banking entity to ensure that all activities and investments conducted by the banking entity that are subject to section 13 of the BHC Act and this part comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and this part and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in this part or by management as requiring attention;

(4) Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a banking entity must promptly provide to the OCC upon request and retain for a period of no less than 5 years or such longer period as required by the OCC.

(c) *Additional standards.* In addition to the requirements in paragraph (b) of this section, the compliance program of a banking entity must satisfy the requirements and other standards contained in appendix B, if:

(1) The banking entity engages in proprietary trading permitted under subpart B and is required to comply

with the reporting requirements of paragraph (d) of this section;

(2) The banking entity has reported total consolidated assets as of the previous calendar year end of $50 billion or more or, in the case of a foreign banking entity, has total U.S. assets as of the previous calendar year end of $50 billion or more (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States); or

(3) The OCC notifies the banking entity in writing that it must satisfy the requirements and other standards contained in appendix B to this part.

(d) *Reporting requirements under appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A, if:

(i) The banking entity (other than a foreign banking entity as provided in paragraph (d)(1)(ii) of this section) has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section;

(ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section; or

(iii) The OCC notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A.

(2) The threshold for reporting under paragraph (d)(1) of this section shall be $50 billion beginning on June 30, 2014; $25 billion beginning on April 30, 2016; and $10 billion beginning on December 31, 2016.

(3) Frequency of reporting: Unless the OCC notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with paragraph (d)(1) of this section) shall report the information required by appendix A for each calendar month within 30 days of the end of the relevant calendar month; beginning with information for the month of January 2015, such information shall be reported within 10 days of the end of each calendar month. Any other banking entity subject to appendix A shall report the information required by appendix A for each calendar quarter within 30 days of the end of that calendar quarter unless the OCC notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* Any banking entity that has more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years shall maintain records that include:

(1) Documentation of the exclusions or exemptions other than sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund;

(2) For each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of covered fund provided by § 44.10(c)(1), §44.10(c)(5), §44.10(c)(8), §44.10(c)(9), or § 44.10(c)(10) of subpart C, documentation supporting the banking entity's determination that the fund is not a covered fund pursuant to one or more of those exclusions;

(3) For each seeding vehicle described in § 44.10(c)(12)(i) or (iii) of subpart C that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § 44.12(a)(2)(i)(B) of subpart C;

(4) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, if the aggregate amount of ownership interests in foreign public funds that are described in § 44.10(c)(1) of subpart C owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or of any State) exceeds $50 million at the end of two or more consecutive calendar quarters, beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar quarter, which documentation must continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters; and

(5) For purposes of paragraph (e)(4) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(f) *Simplified programs for less active banking entities*—(1) *Banking entities with no covered activities.* A banking entity that does not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § 44.6(a) of subpart B) may satisfy the requirements of this section by establishing the required compliance program prior to becoming engaged in such activities or making such investments (other than trading activities permitted pursuant to § 44.6(a) of subpart B).

(2) *Banking entities with modest activities.* A banking entity with total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engages in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted under § 44.6(a) of subpart B) may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope and complexity of the banking entity.

§ 44.21 Termination of activities or investments; penalties for violations.

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the OCC finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or this part, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or this part, the OCC may take any action permitted by law to enforce compliance with section 13 of the BHC Act and this part, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

Appendix A to Part 44—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 44.20(d), this appendix generally applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the OCC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 44.20 and Appendix B.

b. The purpose of this appendix is to assist banking entities and the OCC in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 44.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 44.4, 44.5, or 44.6(a)–(b) (*i.e.,* underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the OCC of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. The quantitative measurements that must be furnished pursuant to this appendix are *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In order to allow banking entities and the Agencies to evaluate the effectiveness of these metrics, banking entities must collect and report these metrics for all trading desks beginning on the dates established in § 44.20 of the final rule. The Agencies will review the data collected and revise this collection requirement as appropriate based on a review of the data collected prior to September 30, 2015.

e. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 44.20 and Appendix B to this part. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

f. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 44.4 through 44.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the OCC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 44.2 and 44.3. In addition, for purposes of this appendix, the following definitions apply:

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 44.4, 44.5, 44.6(a), or 44.6(b). A banking entity may include trading under §§ 44.3(d), 44.6(c), 44.6(d) or 44.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading desk means 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.

III. Reporting and Recordkeeping of Quantitative Measurements

a. Scope of Required Reporting

General scope. Each banking entity made subject to this part by § 44.20 must furnish the following quantitative measurements for each trading desk of the banking entity, calculated in accordance with this appendix:

- Risk and Position Limits and Usage;
- Risk Factor Sensitivities;
- Value-at-Risk and Stress VaR;
- Comprehensive Profit and Loss Attribution;
- Inventory Turnover;
- Inventory Aging; and
- Customer-Facing Trade Ratio.

b. Frequency of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report each applicable quantitative measurement to the OCC on the reporting schedule established in § 44.20 unless otherwise requested by the OCC. All quantitative measurements for any calendar month must be reported within the time period required by § 44.20.

c. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the OCC pursuant to this appendix and § 44.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the OCC to verify the accuracy of such reports, for a period of 5 years from the end of the calendar year for which the measurement was taken.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the portion of the trading desk's limits that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited, to the limits set out in § 44.4 and § 44.5. A number of the metrics that are described below, including ''Risk Factor Sensitivities'' and ''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 activities under § 44.4(b) and hedging activity under § 44.5. Accordingly, the limits required under § 44.4(b)(2)(iii) and § 44.5(b)(1)(i) must meet the applicable requirements under § 44.4(b)(2)(iii) and § 44.5(b)(1)(i) and also must include appropriate metrics for the trading desk limits including, at a minimum, the ''Risk Factor Sensitivities'' and ''Value-at-Risk and Stress Value-at-Risk'' metrics except to the extent any of the ''Risk Factor Sensitivities'' or ''Value-at-Risk and Stress Value-at-Risk'' metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

ii. *General Calculation Guidance:* Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached must be reported.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

2. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk.

ii. *General Calculation Guidance:* A banking entity must report the Risk Factor Sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. The underlying data and methods used to compute a trading desk's Risk Factor Sensitivities will depend on the specific function of the trading desk and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading desk, and furnished to the OCC, will depend on the explicit risks assumed by the trading desk. In general, however, reported Risk Factor Sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings.

A. Trading desks must take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:

• *Commodity derivative positions:* Risk factors with respect to the related commodities set out in 17 CFR 20.2, the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;

• *Credit positions:* Risk factors with respect to credit spreads that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and risk factors with respect to interest rates of all relevant maturities;

• *Credit-related derivative positions:* Risk factor sensitivities, for example credit spreads, shifts (parallel and non-parallel) in credit spreads—volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;

• *Equity derivative positions:* Risk factor sensitivities such as equity positions, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;

• *Equity positions:* Risk factors for equity prices and risk factors that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;

• *Foreign exchange derivative positions:* Risk factors with respect to major currency pairs and maturities, exposure to interest rates at relevant maturities, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and

• *Interest rate positions, including interest rate derivative positions:* Risk factors with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and shifts (parallel and non-parallel) in the interest rate curve, as well as the maturity profile of the positions.

B. The methods used by a banking entity to calculate sensitivities to a common factor shared by multiple trading desks, such as an equity price factor, must be applied consistently across its trading desks so that the sensitivities can be compared from one trading desk to another.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Value-at-Risk and Stress Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the commonly used percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on current market conditions. For purposes of this appendix, Stress Value-at-Risk (''Stress VaR'') is the percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on market conditions during a period of significant financial stress.

ii. *General Calculation Guidance:* Banking entities must compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading desk that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR must be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions''); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (*i.e.,* the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific Risk Factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

C. The portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *General Calculation Guidance:* The specific categories used by a trading desk in the attribution analysis and amount of detail for the analysis should be tailored to the type and amount of trading activities undertaken by the trading desk. The new position attribution must be computed by calculating the difference between the prices at which instruments were bought and/or sold and the prices at which those instruments are marked to market at the close of business on that day multiplied by the notional or principal amount of each purchase or sale. Any fees, commissions, or other payments received (paid) that are associated with transactions executed on that day must be added (subtracted) from such difference. These factors must be measured consistently over time to facilitate historical comparisons.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

c. Customer-Facing Activity Measurements

1. Inventory Turnover

i. *Description:* For purposes of this appendix, Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period.

ii. *General Calculation Guidance:* For purposes of this appendix, for derivatives, other than options and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

2. Inventory Aging

i. *Description:* For purposes of this appendix, Inventory Aging generally describes a schedule of the trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held. Inventory Aging should measure the age profile of the trading desk's assets and liabilities.

ii. *General Calculation Guidance:* In general, Inventory Aging must be computed using a trading desk's trading activity data and must identify the value of a trading desk's aggregate assets and liabilities. Inventory Aging must include two schedules, an asset-aging schedule and a liability-aging schedule. Each schedule must record the value of assets or liabilities held over all holding periods. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value and, for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Customer-Facing Trade Ratio—Trade Count Based and Value Based

i. *Description:* For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A trade count based ratio must be computed that records the number of transactions involving a counterparty that is a customer of the trading desk and the number of transactions involving a counterparty that is not a customer of the trading desk. A value based ratio must be computed that records the value of transactions involving a counterparty that is a customer of the trading desk and the value of transactions involving a counterparty that is not a customer of the trading desk.

ii. *General Calculation Guidance:* For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 44.20(d)(1) unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

Appendix B to Part 44—Enhanced Minimum Standards for Compliance Programs

I. Overview

Section 44.20(c) requires certain banking entities to establish, maintain, and enforce an enhanced compliance program that includes the requirements and standards in this Appendix as well as the minimum written policies and procedures, internal controls, management framework, independent testing, training, and recordkeeping provisions outlined in § 44.20. This Appendix sets forth additional minimum standards with respect to the establishment, oversight, maintenance, and enforcement by these banking entities of an enhanced internal compliance program for ensuring and monitoring 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 this part.

a. This compliance program must:

1. Be reasonably designed to identify, document, monitor, and report the permitted trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these covered activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and this part;

2. Establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and this part;

3. Subject the effectiveness of the compliance program to periodic independent review and testing, and ensure that the entity's internal audit, corporate compliance and internal control functions involved in review and testing are effective and independent;

4. Make senior management, and others as appropriate, accountable for the effective implementation of the compliance program, and ensure that the board of directors and chief executive officer (or equivalent) of the banking entity review the effectiveness of the compliance program; and

5. Facilitate supervision and examination by the Agencies of the banking entity's permitted trading and covered fund activities and investments.

II. Enhanced Compliance Program

a. *Proprietary Trading Activities.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, and complexity of, and risks associated with, its permitted trading activities. The compliance program may be tailored to the types of trading activities conducted by the banking entity, and must include a detailed description of controls established by the banking entity to reasonably ensure that its trading activities are conducted in accordance with the requirements and limitations applicable to those trading activities under section 13 of the BHC Act and this part, and provide for appropriate revision of the compliance program before expansion of the trading activities of the banking entity. A banking entity must devote adequate resources and use knowledgeable personnel in conducting, supervising and managing its trading activities, and promote consistency, independence and rigor in implementing its risk controls and compliance efforts. The compliance program must be updated with a frequency sufficient to account for changes in the activities of the banking entity, results of independent testing of the program, identification of weaknesses in the program, and changes in legal, regulatory or other requirements.

1. *Trading Desks:* The banking entity must have written policies and procedures governing each trading desk that include a description of:

i. The process for identifying, authorizing and documenting financial instruments each trading desk may purchase or sell, with separate documentation for market making-related activities conducted in reliance on § 44.4(b) and for hedging activity conducted in reliance on § 44.5;

ii. A mapping for each trading desk to the division, business line, or other organizational structure that is responsible for managing and overseeing the trading desk's activities;

iii. The mission (*i.e.,* the type of trading activity, such as market-making, trading in sovereign debt, etc.) and strategy (*i.e.,* methods for conducting authorized trading activities) of each trading desk;

iv. The activities that the trading desk is authorized to conduct, including (i) authorized instruments and products, and (ii) authorized hedging strategies, techniques and instruments;

v. The types and amount of risks allocated by the banking entity to each trading desk to implement the mission and strategy of the trading desk, including an enumeration of material risks resulting from the activities in which the trading desk is authorized to engage (including but not limited to price risks, such as basis, volatility and correlation risks, as well as counterparty credit risk). Risk assessments must take into account both the risks inherent in the trading activity and the strength and effectiveness of controls designed to mitigate those risks;

vi. How the risks allocated to each trading desk will be measured;

vii. Why the allocated risks levels are appropriate to the activities authorized for the trading desk;

viii. The limits on the holding period of, and the risk associated with, financial instruments under the responsibility of the trading desk;

ix. The process for setting new or revised limits, as well as escalation procedures for granting exceptions to any limits or to any policies or procedures governing the desk, the analysis that will be required to support revising limits or granting exceptions, and the process for independently reviewing and documenting those exceptions and the underlying analysis;

x. The process for identifying, documenting and approving new products, trading strategies, and hedging strategies;

xi. The types of clients, customers, and counterparties with whom the trading desk may trade; and

xii. The compensation arrangements, including incentive arrangements, for employees associated with the trading desk, which may not be designed to reward or incentivize prohibited proprietary trading or excessive or imprudent risk-taking.

2. *Description of risks and risk management processes:* The compliance program for the banking entity must include a comprehensive description of the risk management program for the trading activity of the banking entity. The compliance program must also include a description of the governance, approval, reporting, escalation, review and other processes the banking entity will use to reasonably ensure that trading activity is conducted in compliance with section 13 of the BHC Act and this part. Trading activity in similar financial instruments should be subject to similar governance, limits, testing, controls, and review, unless the banking entity specifically determines to establish different limits or processes and documents those differences. Descriptions must include, at a minimum, the following elements:

i. A description of the supervisory and risk management structure governing all trading activity, including a description of processes for initial and senior-level review of new products and new strategies;

ii. A description of the process for developing, documenting, testing, approving and reviewing all models used for valuing, identifying and monitoring the risks of trading activity and related positions, including the process for periodic independent testing of the reliability and accuracy of those models;

iii. A description of the process for developing, documenting, testing, approving and reviewing the limits established for each trading desk;

iv. A description of the process by which a security may be purchased or sold pursuant to the liquidity management plan, including the process for authorizing and monitoring such activity to ensure compliance with the banking entity's liquidity management plan and the restrictions on liquidity management activities in this part;

v. A description of the management review process, including escalation procedures, for approving any temporary exceptions or permanent adjustments to limits on the activities, positions, strategies, or risks associated with each trading desk; and

vi. The role of the audit, compliance, risk management and other relevant units for conducting independent testing of trading and hedging activities, techniques and strategies.

3. *Authorized risks, instruments, and products.* The banking entity must implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that trading activity is conducted in conformance with section 13 of the BHC Act and this part and with the banking entity's written policies and procedures. The banking entity must establish and enforce risk limits appropriate for the activity of each trading desk. These limits should be based on probabilistic and non-probabilistic measures of potential loss (*e.g.,* Value-at-Risk and notional exposure, respectively), and measured under normal and stress market conditions. At a minimum, these internal controls must monitor, establish and enforce limits on:

i. The financial instruments (including, at a minimum, by type and exposure) that the trading desk may trade;

ii. The types and levels of risks that may be taken by each trading desk; and

iii. The types of hedging instruments used, hedging strategies employed, and the amount of risk effectively hedged.

4. *Hedging policies and procedures.* The banking entity must establish, maintain, and enforce written policies and procedures regarding the use of risk-mitigating hedging instruments and strategies that, at a minimum, describe:

i. The positions, techniques and strategies that each trading desk may use to hedge the risk of its positions;

ii. The manner in which the banking entity will identify the risks arising in connection with and related to the individual or aggregated positions, contracts or other holdings of the banking entity that are to be hedged and determine that those risks have been properly and effectively hedged;

iii. The level of the organization at which hedging activity and management will occur;

iv. The manner in which hedging strategies will be monitored and the personnel responsible for such monitoring;

v. The risk management processes used to control unhedged or residual risks; and

vi. The process for developing, documenting, testing, approving and reviewing all hedging positions, techniques and strategies permitted for each trading desk and for the banking entity in reliance on § 44.5.

5. *Analysis and quantitative measurements.* The banking entity must perform robust analysis and quantitative measurement of its trading activities that is reasonably designed to ensure that the trading activity of each trading desk is consistent with the banking entity's compliance program; monitor and assist in the identification of potential and actual prohibited proprietary trading activity; and prevent the occurrence of prohibited proprietary trading. Analysis and models used to determine, measure and limit risk must be rigorously tested and be reviewed by management responsible for trading activity to ensure that trading activities, limits, strategies, and hedging activities do not understate the risk and exposure to the banking entity or allow prohibited proprietary trading. This review should include periodic and independent back-testing and revision of activities, limits, strategies and hedging as appropriate to contain risk and ensure compliance. In addition to the quantitative measurements reported by any banking entity subject to Appendix A to this part, each banking entity

must develop and implement, to the extent appropriate to facilitate compliance with this part, additional quantitative measurements specifically tailored to the particular risks, practices, and strategies of its trading desks. The banking entity's analysis and quantitative measurements must incorporate the quantitative measurements reported by the banking entity pursuant to Appendix A (if applicable) and include, at a minimum, the following:

i. Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of quantitative measurements;

ii. Ongoing, timely monitoring and review of calculated quantitative measurements;

iii. The establishment of numerical thresholds and appropriate trading measures for each trading desk and heightened review of trading activity not consistent with those thresholds to ensure compliance with section 13 of the BHC Act and this part, including analysis of the measurement results or other information, appropriate escalation procedures, and documentation related to the review; and

iv. Immediate review and compliance investigation of the trading desk's activities, escalation to senior management with oversight responsibilities for the applicable trading desk, timely notification to the OCC, appropriate remedial action (*e.g.,* divesting of impermissible positions, cessation of impermissible activity, disciplinary actions), and documentation of the investigation findings and remedial action taken when quantitative measurements or other information, considered together with the facts and circumstances, or findings of internal audit, independent testing or other review suggest a reasonable likelihood that the trading desk has violated any part of section 13 of the BHC Act or this part.

6. *Other Compliance Matters.* In addition to the requirements specified above, the banking entity's compliance program must:

i. Identify activities of each trading desk that will be conducted in reliance on exemptions contained in §§ 44.4 through 44.6, including an explanation of:

A. How and where in the organization the activity occurs; and

B. Which exemption is being relied on and how the activity meets the specific requirements for reliance on the applicable exemption;

ii. Include an explanation of the process for documenting, approving and reviewing actions taken pursuant to the liquidity management plan, where in the organization this activity occurs, the securities permissible for liquidity management, the process for ensuring that liquidity management activities are not conducted for the purpose of prohibited proprietary trading, and the process for ensuring that securities purchased as part of the liquidity management plan are highly liquid and conform to the requirements of this part;

iii. Describe how the banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each trading desk that relies on the exemptions contained in §§ 44.3(d)(3), and 44.4 through 44.6, which must take into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in value cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that result in large and significant concentrations to sectors, risk factors, or counterparties;

iv. Establish responsibility for compliance with the reporting and recordkeeping requirements of subpart B and § 44.20; and

v. Establish policies for monitoring and prohibiting potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties.

7. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any trading activity that may indicate potential violations of section 13 of the BHC Act and this part and to prevent actual violations of section 13 of the BHC Act and this part. The compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

b. *Covered Fund Activities or Investments.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, complexity and risks of the covered fund and related activities conducted and investments made, by the banking entity.

1. *Identification of covered funds.* The banking entity's compliance program must provide a process, which must include appropriate management review and independent testing, for identifying and documenting covered funds that each unit within the banking entity's organization sponsors or organizes and offers, and covered funds in which each such unit invests. In addition to the documentation requirements for covered funds, as specified under § 44.20(e), the documentation must include information that identifies all pools that the banking entity sponsors or has an interest in and the type of exemption from the Commodity Exchange Act (whether or not the pool relies on section 4.7 of the regulations under the Commodity Exchange Act), and the amount of ownership interest the banking entity has in those pools.

2. *Identification of covered fund activities and investments.* The banking entity's compliance program must identify, document and map each unit within the organization that is permitted to acquire or hold an interest in any covered fund or sponsor any covered fund and map each unit to the division, business line, or other organizational structure that will be responsible for managing and overseeing that unit's activities and investments.

3. *Explanation of compliance.* The banking entity's compliance program must explain how:

i. The banking entity monitors for and prohibits potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties related to its covered fund activities and investments;

ii. The banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the banking entity related to its covered fund activities and investments; and

iii. The banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by its covered fund activities and investments, taking into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in values cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that expose the banking entity to large and significant concentrations with respect to sectors, risk factors, or counterparties;

4. *Description and documentation of covered fund activities and investments.* For each organizational unit engaged in covered fund activities and investments, the banking entity's compliance program must document:

i. The covered fund activities and investments that the unit is authorized to conduct;

ii. The banking entity's plan for actively seeking unaffiliated investors to ensure that any investment by the banking entity conforms to the limits contained in § 44.12 or registered in compliance with the securities laws and thereby exempt from those limits within the time periods allotted in § 44.12; and

iii. How it complies with the requirements of subpart C.

5. *Internal Controls.* A banking entity must establish, maintain, and enforce internal controls that are reasonably designed to ensure that its covered fund activities or investments comply with the requirements of section 13 of the BHC Act and this part and are appropriate given the limits on risk established by the banking entity. These written internal controls must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part. The internal controls must, at a minimum require:

i. Monitoring and limiting the banking entity's individual and aggregate investments in covered funds;

ii. Monitoring the amount and timing of seed capital investments for compliance with the limitations under subpart C (including but not limited to the redemption, sale or disposition requirements) of § 44.12, and the effectiveness of efforts to seek unaffiliated investors to ensure compliance with those limits;

iii. Calculating the individual and aggregate levels of ownership interests in one or more covered fund required by § 44.12;

iv. Attributing the appropriate instruments to the individual and aggregate ownership interest calculations above;

v. Making disclosures to prospective and actual investors in any covered fund organized and offered or sponsored by the banking entity, as provided under § 44.11(a)(8);

vi. Monitoring for and preventing any relationship or transaction between the banking entity and a covered fund that is prohibited under § 44.14, including where the banking entity has been designated as the sponsor, investment manager, investment adviser, or commodity trading advisor to a covered fund by another banking entity; and

vii. Appropriate management review and supervision across legal entities of the banking entity to ensure that services and products provided by all affiliated entities comply with the limitation on services and products contained in § 44.14.

6. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part and to prevent actual violations of section 13 of the BHC Act and this part. The banking entity's compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, including § 44.21, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity or investment indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

III. Responsibility and Accountability for the Compliance Program

a. A banking entity must establish, maintain, and enforce a governance and management framework to manage its business and employees with a view to preventing violations of section 13 of the BHC Act and this part. A banking entity must have an appropriate management framework reasonably designed to ensure that: Appropriate personnel are responsible and accountable for the effective implementation and enforcement of the compliance program; a clear reporting line with a chain of responsibility is delineated; and the compliance program is reviewed periodically by senior management. The board of directors (or equivalent governance body) and senior management should have the appropriate authority and access to personnel and information within the organizations as well as appropriate resources to conduct their oversight activities effectively.

1. *Corporate governance.* The banking entity must adopt a written compliance program approved by the board of directors, an appropriate committee of the board, or equivalent governance body, and senior management.

2. *Management procedures.* The banking entity must establish, maintain, and enforce a governance framework that is reasonably designed to achieve compliance with section 13 of the BHC Act and this part, which, at a minimum, provides for:

i. The designation of appropriate senior management or committee of senior management with authority to carry out the management responsibilities of the banking entity for each trading desk and for each organizational unit engaged in covered fund activities;

ii. Written procedures addressing the management of the activities of the banking entity that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, including:

A. A description of the management system, including the titles, qualifications, and locations of managers and the specific responsibilities of each person with respect to the banking entity's activities governed by section 13 of the BHC Act and this part; and

B. Procedures for determining compensation arrangements for traders engaged in underwriting or market making-related activities under § 44.4 or risk-mitigating hedging activities under § 44.5 so that such compensation arrangements are designed not to reward or incentivize prohibited proprietary trading and appropriately balance risk and financial results in a manner that does not encourage employees to expose the banking entity to excessive or imprudent risk.

3. *Business line managers.* Managers with responsibility for one or more trading desks of the banking entity are accountable for the effective implementation and enforcement of the compliance program with respect to the applicable trading desk(s).

4. *Board of directors, or similar corporate body, and senior management.* The board of directors, or similar corporate body, and senior management are responsible for setting and communicating an appropriate culture of compliance with section 13 of the BHC Act and this part and ensuring that appropriate policies regarding the management of trading activities and covered fund activities or investments are adopted to comply with section 13 of the BHC Act and this part. The board of directors or similar corporate body (such as a designated committee of the board or an equivalent governance body) must ensure that senior management is fully capable, qualified, and properly motivated to manage compliance with this part in light of the organization's business activities and the expectations of the board of directors. The board of directors or similar corporate body must also ensure that senior management has established appropriate incentives and adequate resources to support compliance with this part, including the implementation of a compliance program meeting the requirements of this appendix into management goals and compensation structures across the banking entity.

5. *Senior management.* Senior management is responsible for implementing and enforcing the approved compliance program. Senior management must also ensure that effective corrective action is taken when failures in compliance with section 13 of the BHC Act and this part are identified. Senior management and control personnel charged with overseeing compliance with section 13 of the BHC Act and this part should review the compliance program for the banking entity periodically and report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading activities and covered fund activities or investments, which shall be at least annually.

6. *CEO attestation.* Based on a review by the CEO of the banking entity, the CEO of the banking entity must, annually, attest in writing to the OCC that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under this Appendix and § 44.20 of this part in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the United States operations of the foreign banking entity who is located in the United States.

IV. Independent Testing

a. Independent testing must occur with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading and covered fund activities or investments, which shall be at least annually. This independent testing must include an evaluation of:

1. The overall adequacy and effectiveness of the banking entity's compliance program, including an analysis of the extent to which the program contains all the required elements of this appendix;

2. The effectiveness of the banking entity's internal controls, including an analysis and documentation of instances in which such internal controls have been breached, and how such breaches were addressed and resolved; and

3. The effectiveness of the banking entity's management procedures.

b. A banking entity must ensure that independent testing regarding the effectiveness of the banking entity's compliance program is conducted by a qualified independent party, such as the banking entity's internal audit department, compliance personnel or risk managers independent of the organizational unit being tested, outside auditors, consultants, or other qualified independent parties. A banking entity must promptly take appropriate action to remedy any significant deficiencies or material weaknesses in its compliance program and to terminate any violations of section 13 of the BHC Act or this part.

V. Training

Banking entities must provide adequate training to personnel and managers of the banking entity engaged in activities or investments governed by section 13 of the BHC Act or this part, as well as other appropriate supervisory, risk, independent testing, and audit personnel, in order to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the banking entity's trading activities and covered fund activities or investments.

VI. Recordkeeping

Banking entities must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A banking entity must retain these records for a period that is no less than 5 years or such longer period as required by the OCC in a form that allows it to promptly produce such records to the OCC on request.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE

12 CFR Chapter II

Authority and Issuance

For the reasons stated in the Common Preamble, the Board amends chapter I of Title 12, Code of Federal Regulations as follows:

PART 248—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS (Regulation VV)

■ 16. The authority citation for part 248 continues to read as follows:

Authority: 12 U.S.C. 1851, 12 U.S.C. 221 *et seq.,* 12 U.S.C. 1818, 12 U.S.C. 1841 *et seq.,* and 12 U.S.C. 3103 *et seq.*

Subpart A—Authority and Definitions

■ 17. Section 248.2 is revised to read as follows:

§ 248.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in § 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Limited trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 248.6(a)(1) and (2) of subpart B) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion; and

(ii) The Board has not determined pursuant to § 248.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (s)(3) of this section, trading assets and liabilities for purposes of this paragraph (s) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 248.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (s) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 248.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

(ii) For purposes of paragraph (s)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (s)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States, including branches outside the United States that are managed or controlled by a U.S. branch or agency of the foreign banking organization, for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(t) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(u) *Moderate trading assets and liabilities* means, with respect to a banking entity, that the banking entity does not have significant trading assets and liabilities or limited trading assets and liabilities.

(v) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(w) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(x) *Qualifying foreign banking organization* means a foreign banking organization that qualifies as such under § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(y) *SEC* means the Securities and Exchange Commission.

(z) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(aa) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(bb) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(cc) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(dd) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(ee) *Significant trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $20 billion; or

(ii) The Board has determined pursuant to § 248.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity, other than a banking entity described in paragraph (ee)(3) of this section, trading assets and liabilities for purposes of this paragraph (ee) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 248.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (ee) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 248.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States as well as branches outside the United States that are managed or controlled by a branch or agency of the foreign banking entity operating, located or organized in the United States).

(ii) For purposes of paragraph (ee)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (ee)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(ff) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(gg) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(hh) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ii) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

■ 18. Section 248.3 is amended by:
■ a. Revising paragraphs (b) and (d)(3), (8), and (9);
■ b. Adding paragraphs (d)(10) through (13);
■ c. Redesignating paragraphs (e)(5) through (13) as paragraphs (e)(6) through (14);
■ d. Adding new paragraph (e)(5); and
■ e. Revising newly redesignated paragraphs (e)(11), (12), and (14).

The revisions and additions read as follows:

§ 248.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account.* (1) *Trading account.* Trading account means:

(i) Any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from the purchases or sales of financial instruments described in this paragraph;

(ii) Any account that is used by a banking entity to purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, 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; or

(iii) Any account that is used by a banking entity to purchase or sell one or more financial instruments, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Trading account application for certain banking entities.* (i) A banking entity that is subject to paragraph (b)(1)(ii) of this section in determining the scope of its trading account is not subject to paragraph (b)(1)(i) of this section.

(ii) A banking entity that does not calculate risk-based capital ratios under the market risk capital rule and is not a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk based capital ratios under the market risk capital rule may elect to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph. A banking entity that elects under this subsection to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph is not required to apply paragraph (b)(1)(i) of this section.

(3) *Consistency of account election for certain banking entities.* (i) Any election or change to an election under paragraph (b)(2)(ii) of this section must apply to the electing banking entity and all of its wholly owned subsidiaries. The primary financial regulatory agency of a banking entity that is affiliated with but is not a wholly owned subsidiary of such electing banking entity may require that the banking entity be subject to this uniform application requirement if the primary financial regulatory agency determines that it is necessary to prevent evasion of the requirements of this part after notice and opportunity for response as provided in subpart D of this part.

(ii) A banking entity that does not elect under paragraph (b)(2)(ii) of this section to be subject to the trading account definition in (b)(1)(ii) may continue to apply the trading account definition in paragraph (b)(1)(i) of this section for one year from the date on which it becomes, or becomes a consolidated affiliate for regulatory reporting purposes with, a banking entity that calculates risk-based capital ratios under the market risk capital rule.

(4) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed not to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for sixty days or longer and does not transfer substantially all of the risk of the financial instrument within sixty days of the purchase (or sale).

* * * * *

(d) * * *

(3) Any purchase or sale of a security, foreign exchange forward (as that term

is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), or cross-currency swap by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular financial instruments to be used for liquidity management purposes, the amount, types, and risks of these financial instruments that are consistent with liquidity management, and the liquidity circumstances in which the particular financial instruments may or must be used;

(ii) Requires that any purchase or sale of financial instruments contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any financial instruments purchased or sold for liquidity management purposes be highly liquid and limited to financial instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any financial instruments purchased or sold for liquidity management purposes, together with any other financial instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under § 248.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in this paragraph (d)(3); and

(vi) Is consistent with the Board's supervisory requirements regarding liquidity management;

* * * * *

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity;

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the Board;

(10) Any purchase or sale of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error;

(11) Contemporaneously entering into a customer-driven swap or customer-driven security-based swap and a matched swap or security-based swap if:

(i) The banking entity retains no more than minimal price risk; and

(ii) The banking entity is not a registered dealer, swap dealer, or security-based swap dealer;

(12) Any purchase or sale of one or more financial instruments that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy; or

(13) Any purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form for a banking entity as of January 1, 2020.

(e) * * *

(5) *Cross-currency swap* means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

* * * * *

(11) *Market risk capital rule covered position and trading position* means a financial instrument that meets the criteria to be a covered position and a trading position, as those terms are respectively defined, without regard to whether the financial instrument is reported as a covered position or trading position on any applicable regulatory reporting forms:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(12) *Market risk capital rule* means the market risk capital rule that is contained in 12 CFR part 3 with respect to a banking entity for which the OCC is the primary financial regulatory agency, 12 CFR part 217 with respect to a banking entity for which the Board is the primary financial regulatory agency, or 12 CFR part 324 with respect to a banking entity for which the FDIC is the primary financial regulatory agency.

* * * * *

(14) *Trading desk* means a 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 that is:

(i)(A) Structured by the banking entity to implement a well-defined business strategy;

(B) Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies; and

(C) Characterized by a clearly defined unit that:

(*1*) Engages in coordinated trading activity with a unified approach to its key elements;

(*2*) Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;

(*3*) Submits compliance reports and other information as a unit for monitoring by management; and

(*4*) Books its trades together; or

(ii) For a banking entity that calculates risk-based capital ratios under the market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the market risk capital rule.

■ 19. Section 248.4 is revised to read as follows:

§ 248.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 248.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii)(A) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities; and

(B) Reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with paragraph (a)(2)(ii)(A) of this section;

(C) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (a)(2)(iii)(B) and (C) of this section by complying with the requirements set forth in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a distribution of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this section, *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 248.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure, routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The trading desk's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this paragraph (b), including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, in accordance with paragraph (b)(2)(ii) of this section;

(D) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(E) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (b)(2)(iii)(C) and (D) of this section by complying with the requirements set forth in paragraph (c) of this section.

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of this paragraph (b), the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with the methodology described in § 248.2(ee) of this part, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(ii) [Reserved]

(4) *Definition of financial exposure.* For purposes of this section, *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker positions.* For the purposes of this section, *market-maker positions* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

(c) *Rebuttable presumption of compliance*—(1) *Internal limits.* (i) A banking entity shall be presumed to meet the requirement in paragraph (a)(2)(ii)(A) or (b)(2)(ii) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the internal limits for the relevant trading desk as described in paragraph (c)(1)(ii) of this section.

(ii)(A) With respect to underwriting activities conducted pursuant to paragraph (a) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of securities and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's underwriting activities, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held.

(B) With respect to market making-related activities conducted pursuant to paragraph (b) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's market-making related activities, that address the:

(*1*) Amount, types, and risks of its market-maker positions;

(*2*) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) Level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) Period of time a financial instrument may be held.

(2) *Supervisory review and oversight.* The limits described in paragraph (c)(1) of this section shall be subject to supervisory review and oversight by the Board on an ongoing basis.

(3) *Limit breaches and increases.* (i) With respect to any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, a banking entity shall maintain and make available to the Board upon request records regarding:

(A) Any limit that is exceeded; and

(B) Any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the Board.

(ii) In the event of a breach or increase of any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, the presumption described in paragraph (c)(1)(i) of this section shall continue to be available only if the banking entity:

(A) Takes action as promptly as possible after a breach to bring the trading desk into compliance; and

(B) Follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval.

(4) *Rebutting the presumption.* The presumption in paragraph (c)(1)(i) of this section may be rebutted by the Board if the Board determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The Board's rebuttal of the presumption in paragraph (c)(1)(i) must be made in accordance with the notice and response procedures in subpart D of this part.

■ 20. Section 248.5 is amended by revising paragraphs (b) and (c)(1) introductory text and adding paragraph (c)(4) to read as follows:

§ 248.5 Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements.* (1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(1) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(2) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(3) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * *

(1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

■ 21. Section 248.6 is amended by revising paragraph (e)(3), removing paragraphs (e)(4) and (6), and redesignating paragraph (e)(5) as paragraph (e)(4).

The revision reads as follows:

§ 248.6 Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including relevant personnel) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United

States or organized under the laws of the United States or of any State.

* * * * *

Subpart C—Covered Funds Activities and Investments

■ 22. Section 248.10 is amended by revising paragraphs (c)(7)(ii) and (c)(8)(i)(A) to read as follows:

§ 248.10 Prohibition on Acquiring or Retaining an Ownership Interest in and Having Certain Relationships with a Covered Fund.

* * * * *

(c) * * *

(7) * * *

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable requirements regarding bank owned life insurance.

(8) * * *

(i) * * *

(A) Loans as defined in § 248.2(t) of subpart A;

* * * * *

■ 23. Section 248.11 is amended by revising paragraph (c) to read as follows:

§ 248.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 248.10(a) does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 248.4(a) or (b), respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78*o*–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 248.12(a)(2)(ii) and (iii) and (d).

§ 248.12 [Amended]

■ 24. Section 248.12 is amended by redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

■ 25. Section 248.13 is amended by revising paragraphs (a), (b)(3) and (4), and (c) to read as follows:

§ 248.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 248.10(a) does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program in accordance with subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising:

(*1*) Out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund; or

(*2*) In connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) With respect to risk-mitigating hedging activity conducted pursuant to paragraph (a)(1)(i), the compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to paragraph (a)(1)(i) and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) * * *

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of this paragraph (b)(3) to participate in any offer or sale by the covered fund of ownership interests in the covered fund.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

(c) *Permitted covered fund interests and activities by a regulated insurance company.* The prohibition contained in § 248.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws and regulations of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law or regulation described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

■ 26. Section 248.14 is amended by revising paragraph (a)(2)(ii)(B) to read as follows:

§ 248.14 Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the Board (with a duty to update the certification if the information in the certification materially changes) 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; and

* * * * *

Subpart D—Compliance Program Requirement; Violations

■ 27. Section 248.20 is amended by revising paragraphs (a), (b) introductory text, (c), (d), (e) introductory text, and (f)(2) and adding paragraphs (g), (h), and (i) to read as follows:

§ 248.20 Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) 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 this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities.* With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation.* The CEO of a banking entity that has significant trading assets and liabilities must, based on a review by the CEO of the banking entity, attest in writing to the Board, each year no later than March 31, that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program required by paragraph (b) of this section in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States.

(d) *Reporting requirements under appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

(i) The banking entity has significant trading assets and liabilities; or

(ii) The Board notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A to this part.

(2) Frequency of reporting: Unless the Board notifies the banking entity in writing that it must report on a different basis, a banking entity subject to appendix A to this part shall report the information required by appendix A for each quarter within 30 days of the end of the quarter.

(e) *Additional documentation for covered funds.* A banking entity with significant trading assets and liabilities shall maintain records that include:

* * * * *

(f) * * *

(2) *Banking entities with moderate trading assets and liabilities.* A banking entity with moderate trading assets and liabilities may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.

(g) Rebuttable presumption of compliance for banking entities with limited trading assets and liabilities—(1) *Rebuttable presumption.* Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities shall be presumed to be compliant with subpart B and subpart C of this part and shall have no obligation to demonstrate compliance with this part on an ongoing basis.

(2) *Rebuttal of presumption.* If upon examination or audit, the Board determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C of this part, the Board may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities. The Board's rebuttal of the presumption in this paragraph must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the Board retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the Board determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C of this part, does not warrant a presumption of compliance under paragraph (g) of this section or treatment as a banking entity with moderate trading assets and liabilities, as applicable. The Board's exercise of this reservation of authority must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(i) *Notice and response procedures*—(1) *Notice.* The Board will notify the banking entity in writing of any determination requiring notice under this part and will provide an explanation of the determination.

(2) *Response.* The banking entity may respond to any or all items in the notice described in paragraph (i)(1) of this section. The response should include any matters that the banking entity would have the Board consider in deciding whether to make the determination. The response must be in writing and delivered to the designated Board official within 30 days after the date on which the banking entity received the notice. The Board may shorten the time period when, in the opinion of the Board, the activities or condition of the banking entity so requires, provided that the banking entity is informed of the time period at the time of notice, or with the consent of the banking entity. In its discretion, the Board may extend the time period for good cause.

(3) *Waiver.* Failure to respond within 30 days or such other time period as may be specified by the Board shall constitute a waiver of any objections to the Board's determination.

(4) *Decision.* The Board will notify the banking entity of the decision in writing. The notice will include an explanation of the decision.

■ 28. Revise appendix A to part 248 to read as follows:

Appendix A to Part 248—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 248.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the Board regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 248.20.

b. The purpose of this appendix is to assist banking entities and the Board in:

(1) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(2) Monitoring the banking entity's covered trading activities;

(3) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(4) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 248.4(b) are consistent with the requirements governing permitted market making-related activities;

(5) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to § 248.4, 248.5, or 248.6(a)–(b) (*i.e.,* underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(6) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by Board of such activities; and

(7) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is not intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 248.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under § 248.4 through 248.6(a)–(b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to Board, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in § 248.2 and § 248.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under § 248.4, § 248.5, § 248.6(a), or § 248.6(b). A banking entity may include in its covered trading activity trading conducted under § 248.3(d), § 248.6(c), § 248.6(d) or § 248.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. Quantitative measurements. Each banking entity made subject to this appendix by § 248.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Internal Limits and Usage;

ii. Value-at-Risk;

iii. Comprehensive Profit and Loss Attribution;

iv. Positions; and

v. Transaction Volumes.

2. Trading desk information. Each banking entity made subject to this appendix by § 248.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. Quantitative measurements identifying information. Each banking entity made subject to this appendix by § 248.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. Narrative statement. Each banking entity made subject to this appendix by § 248.20 may provide an optional narrative statement, as further described in this appendix.

5. File identifying information. Each banking entity made subject to this appendix by § 248.20 must provide file identifying information in each submission to the Board pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. Trading Desk Information

1. Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

i. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;

ii. Identification of each type of covered trading activity in which the trading desk is engaged;

iii. Brief description of the general strategy of the trading desk;

v. A list identifying each Agency receiving the submission of the trading desk;

2. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and

3. Currency reported and daily currency conversion rate.

c. Quantitative Measurements Identifying Information

Each banking entity must provide the following information regarding the quantitative measurements:

1. An Internal Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Internal Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, the unit of measurement for the limit, the type of limit, and identification of the corresponding risk factor attribution in the particular case that the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and

2. A Risk Factor Attribution Information Schedule that provides identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement, including the name of the risk factor or other factor, a unique identification label for the risk factor or other factor, a description of the risk factor or other factor, and the risk factor or other factor's change unit.

d. Narrative Statement

Each banking entity made subject to this appendix by § 248.20 may submit in a separate electronic document a Narrative Statement to the Board with any information the banking entity views as relevant for assessing the information reported. The Narrative Statement may include further description of or changes to calculation methods, identification of material events, description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such changes occurred.

e. Frequency and Method of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the Board on the reporting schedule established in § 248.20 unless otherwise requested by the Board. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the Board in accordance with the XML Schema specified and published on the Board's website.

f. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the Board pursuant to this appendix and § 248.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the Board to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the Board.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Internal Limits and Usage

i. *Description:* For purposes of this appendix, Internal Limits are 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. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Internal limits and their usage are key compliance and risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in §§ 248.4 and 248.5. A trading desk's risk limits, commonly including a limit on ''Value-at-Risk,'' are useful in the broader context of the trading desk's overall activities, particularly for the market making activities under § 248.4(b) and hedging activity under § 248.5. Accordingly, the limits required under §§ 248.4(b)(2)(iii)(C) and 248.5(b)(1)(i)(A) must meet the applicable requirements under §§ 248.4(b)(2)(iii)(C) and 248.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, "Value-at-Risk" except to the extent the "Value-at-Risk" metric is demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

A. A banking entity must provide the following information for each limit reported pursuant to this quantitative measurement: The unique identification label for the limit reported in the Internal Limits Information Schedule, the limit size (distinguishing between an upper and a lower limit), and the value of usage of the limit.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

2. Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the measurement of the risk of future financial loss in the value of a trading desk's aggregated positions at the ninety-nine percent confidence level over a one-day period, based on current market conditions.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into two categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); and (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions'').

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to (i) changes in the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. For the attribution of comprehensive profit and loss from existing positions to specific risk factors and other factors, a banking entity must provide the following information for the factors that explain the preponderance of the profit or loss changes due to risk factor changes: The unique identification label for the risk factor or other factor listed in the Risk Factor Attribution Information Schedule, and the profit or loss due to the risk factor or other factor change.

C. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

D. The portion of comprehensive profit and loss from existing positions that is not attributed to changes in specific risk factors and other factors must be allocated to a residual category. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

c. Positions and Transaction Volumes Measurements

1. Positions

i. *Description:* For purposes of this appendix, Positions is the value of securities and derivatives positions managed by the trading desk. For purposes of the Positions quantitative measurement, do not include in the Positions calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives." [1] A banking entity must separately report the trading desk's market value of long securities positions, short securities positions, derivatives receivables, and derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 248.4(a) or § 248.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description:* For purposes of this appendix, Transaction Volumes measures three exclusive categories of covered trading activity conducted by a trading desk. A banking entity is required to report the value and number of security and derivative transactions conducted by the trading desk with: (i) Customers, excluding internal transactions; (ii) non-customers, excluding internal transactions; and (iii) trading desks and other organizational units where the transaction is booked into either the same banking entity or an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives." [2] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 248.4(a) to conduct underwriting activity is a market participant identified in § 248.4(a)(7), and a customer of a trading desk that relies on § 248.4(b) to conduct market making-related activity is a market participant identified in § 248.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 248.4(a) or § 248.4(b) to conduct underwriting activity or market-making-related activity, respectively.

Appendix B to Part 248 [Removed]

■ 29. Appendix B to part 248 is removed.

■ 30. Effective January 1, 2020, until December 31, 2020, appendix Z to part 248 is added to read as follows:

Appendix Z to Part 248—Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Alternative Compliance)

Note: The content of this appendix reproduces the regulation implementing Section 13 of the Bank Holding Company Act as of November 13, 2019.

Subpart A—Authority and Definitions

§ 248.1 Authority, purpose, scope, and relationship to other authorities.

(a) *Authority.* This part (Regulation VV) is issued by the Board under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851), as well as under the Federal Reserve Act, as amended (12 U.S.C. 221 *et seq.*); section 8 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818); the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*); and the International Banking Act of 1978, as amended (12 U.S.C. 3101 *et seq.*).

(b) *Purpose.* Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and on investments in or relationships with covered funds by certain banking entities, including state member banks, bank holding companies, savings and loan holding companies, other companies that control an insured depository institution, foreign banking organizations, and certain subsidiaries thereof. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and on investments in or relationships with covered funds, and explaining the statute's requirements.

(c) *Scope.* This part implements section 13 of the Bank Holding Company Act with respect to banking entities for which the Board is authorized to issue regulations under section 13(b)(2) of the Bank Holding Company Act (12 U.S.C. 1851(b)(2)) and take actions under section 13(e) of that Act (12 U.S.C. 1851(e)). These include any state bank that is a member of the Federal Reserve System, any company that controls an insured depository institution (including a bank holding company and savings and loan holding company), any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act (12 U.S.C. 3106), and any subsidiary of the foregoing other than a subsidiary for which the OCC, FDIC, CFTC, or SEC is the primary financial regulatory agency (as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5301(12)), but do not include such entities to the extent they are not within the definition of banking entity in § 248.2(c).

(d) *Relationship to other authorities.* Except as otherwise provided under section 13 of the BHC Act or this part, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of BHC Act and this part shall apply to the activities of a banking entity, even if such activities are authorized for the banking entity under other applicable provisions of law.

(e) *Preservation of authority.* Nothing in this part limits in any way the authority of the Board to impose on a banking entity identified in paragraph (c) of this section additional requirements or restrictions with respect to any activity, investment, or relationship covered under section 13 of the Bank Holding Company Act or this part, or additional penalties for violation of this part provided under any other applicable provision of law.

§ 248.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

[1] *See* § 248.2(h), (aa). For example, under this part, a security-based swap is both a "security" and a "derivative." For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.

[2] *See* § 248.2(h), (aa).

(i) A covered fund that is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution,* unless otherwise indicated, has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(t) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(u) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(v) Qualifying foreign banking organization means a foreign banking organization that qualifies as such under section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(w) *SEC* means the Securities and Exchange Commission.

(x) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(y) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(z) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(aa) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(bb) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(cc) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(dd) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ee) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ff) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

§ 248.3 Prohibition on proprietary trading.

(a) *Prohibition.* Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. *Proprietary trading* means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

(b) *Definition of trading account.* (1) Trading account means any account that is used by a banking entity to:

(i) Purchase or sell one or more financial instruments principally for the purpose of:

(A) Short-term resale;

(B) Benefitting from actual or expected short-term price movements;

(C) Realizing short-term arbitrage profits; or

(D) Hedging one or more positions resulting from the purchases or sales of financial instruments described in paragraphs (b)(1)(i)(A), (B), or (C) of this section;

(ii) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(iii) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale), unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section.

(c) *Financial instrument.* (1) *Financial instrument* means:

(i) A security, including an option on a security;

(ii) A derivative, including an option on a derivative; or

(iii) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(2) A financial instrument does not include:

(i) A loan;

(ii) A commodity that is not:

(A) An excluded commodity (other than foreign exchange or currency);

(B) A derivative;

(C) A contract of sale of a commodity for future delivery; or

(D) An option on a contract of sale of a commodity for future delivery; or

(iii) Foreign exchange or currency.

(d) *Proprietary trading.* Proprietary trading does not include:

(1) Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(2) Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(3) Any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular securities to be used for liquidity management purposes, the amount, types, and risks of these securities that are consistent with liquidity management, and the liquidity circumstances in which the particular securities may or must be used;

(ii) Requires that any purchase or sale of securities contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any securities purchased or sold for liquidity management purposes be highly liquid and limited to securities the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any securities purchased or sold for liquidity management purposes, together with any other instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of securities that are not permitted under §§ 248.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (d)(3) of this section; and

(vi) Is consistent with The Board's supervisory requirements, guidance, and expectations regarding liquidity management;

(4) Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments;

(5) Any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(6) Any purchase or sale of one or more financial instruments by a banking entity, so long as:

(i) The purchase (or sale) satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or

(ii) The purchase (or sale) satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding;

(7) Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian;

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity; or

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the Board.

(e) *Definition of other terms related to proprietary trading.* For purposes of this subpart:

(1) *Anonymous* means that each party to a purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale.

(2) *Clearing agency* has the same meaning as in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(3) *Commodity* has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(4) *Contract of sale of a commodity for future delivery* means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27))).

(5) Derivatives clearing organization means:

(i) A derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1);

(ii) A derivatives clearing organization that, pursuant to CFTC regulation, is exempt from the registration requirements under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1); or

(iii) A foreign derivatives clearing organization that, pursuant to CFTC regulation, is permitted to clear for a foreign board of trade that is registered with the CFTC.

(6) *Exchange,* unless the context otherwise requires, means any designated contract market, swap execution facility, or foreign board of trade registered with the CFTC, or, for purposes of securities or security-based swaps, an exchange, as defined under section 3(a)(1) of the Exchange Act (15 U.S.C. 78c(a)(1)), or security-based swap execution facility, as defined under section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)).

(7) *Excluded clearing activities* means:

(i) With respect to customer transactions cleared on a derivatives clearing organization, a clearing agency, or a designated financial market utility, any purchase or sale necessary to correct trading errors made by or on behalf of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(ii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a designated financial market utility; and

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

(8) Designated financial market utility has the same meaning as in section 803(4) of the Dodd-Frank Act (12 U.S.C. 5462(4)).

(9) *Issuer* has the same meaning as in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(10) *Market risk capital rule covered position and trading position* means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(11) *Market risk capital rule* means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

(12) *Municipal security* means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

(13) *Trading desk* means 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.

§ 248.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 248.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held;

(C) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(D) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

(iv) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a *distribution* of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this paragraph (a), *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 248.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on:

(A) The liquidity, maturity, and depth of the market for the relevant types of financial instrument(s); and

(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section, on:

(*1*) The amount, types, and risks of its market-maker inventory;

(*2*) The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) The level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) The period of time a financial instrument may be held;

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of this paragraph (b), and independent review of such demonstrable analysis and approval;

(iv) To the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 248.20(d)(1) of subpart D, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(4) *Definition of financial exposure.* For purposes of this paragraph (b), *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker inventory.* For the purposes of this paragraph (b), *market-maker inventory* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

§ 248.5 Permitted risk-mitigating hedging activities.

(a) *Permitted risk-mitigating hedging activities.* The prohibition contained in § 248.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(1) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(i) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(ii) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(iii) The conduct of analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged;

(2) The risk-mitigating hedging activity:

(i) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(ii) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(iii) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(iv) Is subject to continuing review, monitoring and management by the banking entity that:

(A) Is consistent with the written hedging policies and procedures required under paragraph (b)(1) of this section;

(B) Is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(C) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading; and

(3) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(c) *Documentation requirement.* (1) A banking entity must comply with the requirements of paragraphs (c)(2) and (3) of this section with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

(i) Not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce;

(ii) Established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but that is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures established under paragraph (b)(1) of this section or under § 248.4(b)(2)(iii)(B) of this subpart as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or

(iii) Established to hedge aggregated positions across two or more trading desks.

(2) In connection with any purchase or sale identified in paragraph (c)(1) of this section, a banking entity must, at a minimum, and contemporaneously with the purchase or sale, document:

(i) The specific, identifiable risk(s) of the identified positions, contracts, or other holdings of the banking entity that the purchase or sale is designed to reduce;

(ii) The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and

(iii) The trading desk or other business unit that is establishing and responsible for the hedge.

(3) A banking entity must create and retain records sufficient to demonstrate compliance with the requirements of this paragraph (c) for a period that is no less than five years in a form that allows the banking entity to promptly produce such records to the Board on request, or such longer period as required under other law or this part.

§ 248.6 Other permitted proprietary trading activities.

(a) *Permitted trading in domestic government obligations.* The prohibition contained in § 248.3(a) does not apply to the purchase or sale by a banking entity of a financial instrument that is:

(1) An obligation of, or issued or guaranteed by, the United States;

(2) An obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*);

(3) An obligation of any State or any political subdivision thereof, including any municipal security; or

(4) An obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(b) *Permitted trading in foreign government obligations*—(1) *Affiliates of foreign banking entities in the United States.* The prohibition contained in § 248.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as:

(i) The banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in paragraph (b)(1)(i) of this section is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The purchase or sale as principal is not made by an insured depository institution.

(2) *Foreign affiliates of a U.S. banking entity.* The prohibition contained in § 248.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as:

(i) The foreign entity is a foreign bank, as defined in section 211.2(j) of the Board's Regulation K (12 CFR 211.2(j)), or is regulated by the foreign sovereign as a securities dealer;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

(c) *Permitted trading on behalf of customers*—(1) *Fiduciary transactions.* The prohibition contained in § 248.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as trustee or in a similar fiduciary capacity, so long as:

(i) The transaction is conducted for the account of, or on behalf of, a customer; and

(ii) The banking entity does not have or retain beneficial ownership of the financial instruments.

(2) *Riskless principal transactions.* The prohibition contained in § 248.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(d) *Permitted trading by a regulated insurance company.* The prohibition contained in § 248.3(a) does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if:

(1) The insurance company or its affiliate purchases or sells the financial instruments solely for:

(i) The general account of the insurance company; or

(ii) A separate account established by the insurance company;

(2) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (d)(2) of this section is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

(e) *Permitted trading activities of foreign banking entities.* (1) The prohibition contained in § 248.3(a) does not apply to the purchase or sale of financial instruments by a banking entity if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State;

(ii) The purchase or sale by the banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale meets the requirements of paragraph (e)(3) of this section.

(2) A purchase or sale of financial instruments by a banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (e)(1)(ii) of this section only if:

(i) The purchase or sale is conducted in accordance with the requirements of paragraph (e) of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of any State and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(*1*) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(*2*) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(*3*) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State;

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;

(iv) 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 the laws of the United States or of any State; and

(v) The purchase or sale is not conducted with or through any U.S. entity, other than:

(A) A purchase or sale with the foreign operations of a U.S. entity if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;

(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.

(4) For purposes of this paragraph (e), a U.S. entity is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this paragraph (e), a U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(6) For purposes of this paragraph (e), *unaffiliated market intermediary* means an unaffiliated entity, acting as an intermediary, that is:

(i) A broker or dealer registered with the SEC under section 15 of the Exchange Act or exempt from registration or excluded from regulation as such;

(ii) A swap dealer registered with the CFTC under section 4s of the Commodity Exchange Act or exempt from registration or excluded from regulation as such;

(iii) A security-based swap dealer registered with the SEC under section 15F of the Exchange Act or exempt from registration or excluded from regulation as such; or

(iv) A futures commission merchant registered with the CFTC under section 4f of the Commodity Exchange Act or exempt from registration or excluded from regulation as such.

§ 248.7 Limitations on permitted proprietary trading activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 248.4 through 248.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) Definition of high-risk asset and high-risk trading strategy. For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§§ 248.8–248.9 [Reserved]

Subpart C—Covered Funds Activities and Investments

§ 248.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) *Prohibition.* (1) Except as otherwise provided in this subpart, a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(2) Paragraph (a)(1) of this section does not include acquiring or retaining an ownership interest in a covered fund by a banking entity:

(i) Acting solely as agent, broker, or custodian, so long as;

(A) The activity is conducted for the account of, or on behalf of, a customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest;

(ii) Through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof) that is established and administered in accordance with the law of the United States or a foreign sovereign, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);

(iii) In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event may the banking entity retain such ownership interest for longer than such period permitted by the Board; or

(iv) On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as:

(A) The activity is conducted for the account of, or on behalf of, the customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest.

(b) *Definition of covered fund.* (1) Except as provided in paragraph (c) of this section, covered fund means:

(i) An issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), *but for* section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a–3(c)(1) or (7));

(ii) Any commodity pool under section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10)) for which:

(A) The commodity pool operator has claimed an exemption under 17 CFR 4.7; or

(B)(*1*) A commodity pool operator is registered with the CFTC as a commodity pool operator in connection with the operation of the commodity pool;

(*2*) Substantially all participation units of the commodity pool are owned by qualified eligible persons under 17 CFR 4.7(a)(2) and (3); and

(*3*) Participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons under 17 CFR 4.7(a)(2) and (3); or

(iii) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, an entity that:

(A) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(B) Is, or holds 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; and

(C)(*1*) Has as its sponsor that banking entity (or an affiliate thereof); or

(2) Has issued an ownership interest that is owned directly or indirectly by that banking entity (or an affiliate thereof).

(2) An issuer shall not be deemed to be a covered fund under paragraph (b)(1)(iii) of this section if, were the issuer subject to U.S. securities laws, the issuer could rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act.

(3) For purposes of paragraph (b)(1)(iii) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(c) Notwithstanding paragraph (b) of this section, unless the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine otherwise, a covered fund does not include:

(1) *Foreign public funds.* (i) Subject to paragraphs (ii) and (iii) below, an issuer that:

(A) Is organized or established outside of the United States;

(B) Is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and

(C) Sells ownership interests predominantly through one or more public offerings outside of the United States.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and employees of such entities.

(iii) For purposes of paragraph (c)(1)(i)(C) of this section, the term ''public offering'' means a distribution (as defined in § 248.4(a)(3) of subpart B) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(B) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(C) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

(2) *Wholly-owned subsidiaries.* An entity, all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate thereof), except that:

(i) Up to five percent of the entity's outstanding ownership interests, less any amounts outstanding under paragraph (c)(2)(ii) of this section, may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and

(ii) Up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(3) *Joint ventures.* A joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, provided that the joint venture:

(i) Is comprised of no more than 10 unaffiliated co-venturers;

(ii) 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

(iii) 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.

(4) *Acquisition vehicles.* An issuer:

(i) Formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction; and

(ii) That exists only for such period as necessary to effectuate the transaction.

(5) *Foreign pension or retirement funds.* A plan, fund, or program providing pension, retirement, or similar benefits that is:

(i) Organized and administered outside the United States;

(ii) A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and

(iii) Established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.

(6) *Insurance company separate accounts.* A separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses.

(7) *Bank owned life insurance.* A separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is beneficiary, provided that no banking entity that purchases the policy:

(i) Controls the investment decisions regarding the underlying assets or holdings of the separate account; or

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank owned life insurance.

(8) *Loan securitizations*—(i) *Scope.* An issuing entity for asset-backed securities that satisfies all the conditions of this paragraph (c)(8) and the assets or holdings of which are comprised solely of:

(A) Loans as defined in § 248.2(s) of subpart A;

(B) 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 paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(ii) *Impermissible assets.* For purposes of this paragraph (c)(8), the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraph (c)(8)(iii) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities.* Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives.* The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivative directly relate to the loans, the asset-backed securities, or the contractual rights of other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates.* The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in this paragraph (c)(8);

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under this paragraph (c)(8) and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

(9) *Qualifying asset-backed commercial paper conduits.* (i) An issuing entity for asset-backed commercial paper that satisfies all of the following requirements:

(A) The asset-backed commercial paper conduit holds only:

(*1*) Loans and other assets permissible for a loan securitization under paragraph (c)(8)(i) of this section; and

(*2*) Asset-backed securities supported solely by assets that are permissible for loan securitizations under paragraph (c)(8)(i) of this section and acquired by the asset-backed commercial paper conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or directly from an underwriter in the distribution of the asset-backed securities;

(B) The asset-backed commercial paper conduit issues only asset-backed securities, comprised of a residual interest and securities with a legal maturity of 397 days or less; and

(C) A regulated liquidity provider has entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding asset-backed securities issued by the asset-backed commercial paper conduit (other than any residual interest) in the event that funds are required to redeem maturing asset-backed securities.

(ii) For purposes of this paragraph (c)(9), a regulated liquidity provider means:

(A) A depository institution, as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(B) A bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a subsidiary thereof;

(C) A savings and loan holding company, as defined in section 10a of the Home Owners' Loan Act (12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), or a subsidiary thereof;

(D) A foreign bank whose home country supervisor, as defined in § 211.21(q) of the Board's Regulation K (12 CFR 211.21(q)), has adopted capital standards consistent with the Capital Accord for the Basel Committee on banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(E) The United States or a foreign sovereign.

(10) *Qualifying covered bonds*—(i) *Scope.* An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are comprised solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

(ii) *Covered bond.* For purposes of this paragraph (c)(10), a covered bond means:

(A) A debt obligation issued by an entity that meets the definition of foreign banking organization, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section; or

(B) A debt obligation of an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section, provided that the payment obligations are fully and unconditionally guaranteed by an entity that meets the definition of foreign banking organization and the entity is a wholly-owned subsidiary, as defined in paragraph (c)(2) of this section, of such foreign banking organization.

(11) SBICs and public welfare investment funds. An issuer:

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked; or

(ii) The business of which is to make investments that are:

(A) Designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(12) *Registered investment companies and excluded entities.* An issuer:

(i) 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 as described in § 248.20(e)(3) of subpart D and that complies with the requirements of section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a–18);

(ii) That may rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act; or

(iii) That has elected to be regulated as a business development company 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 business development company as described in § 248.20(e)(3) of subpart D and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a–60).

(13) *Issuers in conjunction with the FDIC's receivership or conservatorship operations.* An issuer that is an entity formed by or on behalf of the FDIC for the purpose of facilitating the disposal of assets acquired in the FDIC's capacity as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(14) *Other excluded issuers.* (i) Any issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act.

(ii) A determination made under paragraph (c)(14)(i) of this section will be promptly made public.

(d) *Definition of other terms related to covered funds.* For purposes of this subpart:

(1) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the Board determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(2) *Asset-backed security* has the meaning specified in Section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)).

(3) *Director* has the same meaning as provided in section 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

(4) *Issuer* has the same meaning as in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(22)).

(5) *Issuing entity* means with respect to asset-backed securities the special purpose vehicle that owns or holds the pool assets underlying asset-backed securities and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

(6) *Ownership interest*—(i) *Ownership interest* means any equity, partnership, or other similar interest. An ''other similar interest'' means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs (d)(6)(i)(A) through (F) of this section.

(ii) *Ownership interest* does not include: *Restricted profit interest.* An interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(A) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(B) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(C) Any amounts invested in the covered fund, including any amounts paid by the entity (or employee or former employee thereof) in connection with obtaining the restricted profit interest, are within the limits of § 248.12 of this subpart; and

(D) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

(7) *Prime brokerage transaction* means 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.

(8) Resident of the United States means a person that is a ''U.S. person'' as defined in rule 902(k) of the SEC's Regulation S (17 CFR 230.902(k)).

(9) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name, except as permitted under § 248.11(a)(6).

(10) *Trustee.* (i) For purposes of paragraph (d)(9) of this section and § 248.11 of subpart C, a trustee does not include:

(A) A trustee that does not exercise investment discretion with respect to a covered fund, including a trustee that is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)); or

(B) A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to those described in paragraph (d)(10)(i)(A) of this section;

(ii) Any entity that directs a person described in paragraph (d)(10)(i) of this section, or that possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee, shall be considered to be a trustee of such covered fund.

§ 248.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

(a) *Organizing and offering a covered fund in general.* Notwithstanding § 248.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund in connection with, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, only if:

(1) The banking entity (or an affiliate thereof) provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services;

(2) The covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity (or an affiliate thereof), pursuant to a written plan or similar documentation outlining how the banking entity or such affiliate intends to provide advisory or similar services to its customers through organizing and offering such fund;

(3) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under § 248.12 of this subpart;

(4) The banking entity and its affiliates comply with the requirements of § 248.14 of this subpart;

(5) The banking entity and its affiliates do 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;

(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof) except that a covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

(A) The investment adviser is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(B) The investment adviser does not share the same name or a variation of the same name as an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(ii) Does not use the word ''bank'' in its name;

(7) No director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity or such affiliate who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

(8) The banking entity:

(i) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(A) That ''any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity] or its affiliates; therefore, [the banking entity's] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity] and any affiliate in its capacity as investor in the [covered fund] or as beneficiary of a restricted profit interest held by [the banking entity] or any affiliate'';

(B) That such investor should read the fund offering documents before investing in the covered fund;

(C) That the ''ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity'' (unless that happens to be the case); and

(D) The role of the banking entity and its affiliates and employees in sponsoring or providing any services to the covered fund; and

(ii) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates.

(b) *Organizing and offering an issuing entity of asset-backed securities.* (1) Notwithstanding §248.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuing entity of asset-backed securities in connection with, directly or indirectly, organizing and offering that issuing entity, so long as the banking entity and its affiliates comply with all of the requirements of paragraph (a)(3) through (8) of this section.

(2) For purposes of this paragraph (b), organizing and offering a covered fund that is an issuing entity of asset-backed securities means acting as the securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)) of the issuing entity, or acquiring or retaining an ownership interest in the issuing entity as required by section 15G of that Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder.

(c) Underwriting and market making in ownership interests of a covered fund. The prohibition contained in § 248.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 248.4(a) or § 248.4(b) of subpart B, respectively;

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o–11(a)(3)), or is acquiring and retaining an ownership interest in

such covered fund in compliance with section 15G of that Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section; or, directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 248.12(a)(2)(ii) and § 248.12(d) of this subpart; and

(3) With respect to any banking entity, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under § 248.11 of this subpart, including all covered funds in which the banking entity holds an ownership interest in connection with underwriting and market making related activities permitted under this paragraph (c), are included in the calculation of all ownership interests under § 248.12(a)(2)(iii) and § 248.12(d) of this subpart.

§ 248.12 Permitted investment in a covered fund.

(a) Authority and limitations on permitted investments in covered funds. (1) Notwithstanding the prohibition contained in § 248.10(a) of this subpart, a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity or an affiliate thereof organizes and offers pursuant to § 248.11, for the purposes of:

(i) *Establishment.* Establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, subject to the limits contained in paragraphs (a)(2)(i) and (iii) of this section; or

(ii) *De minimis investment.* Making and retaining an investment in the covered fund subject to the limits contained in paragraphs (a)(2)(ii) and (iii) of this section.

(2) *Investment limits*—(i) *Seeding period.* With respect to an investment in any covered fund made or held pursuant to paragraph (a)(1)(i) of this section, the banking entity and its affiliates:

(A) Must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) Must, no later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section), conform its ownership interest in the covered fund to the limits in paragraph (a)(2)(ii) of this section;

(ii) *Per-fund limits.* (A) Except as provided in paragraph (a)(2)(ii)(B) of this section, an investment by a banking entity and its affiliates in any covered fund made or held pursuant to paragraph (a)(1)(ii) of this section may not exceed 3 percent of the total number or value of the outstanding ownership interests of the fund.

(B) An investment by a banking entity and its affiliates in a covered fund that is an issuing entity of asset-backed securities may not exceed 3 percent of the total fair market value of the ownership interests of the fund measured in accordance with paragraph (b)(3) of this section, unless a greater percentage is retained by the banking entity and its affiliates in compliance with the requirements of section 15G of the Exchange Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the amount, number, or value of ownership interests of the fund required under section 15G of the Exchange Act and the implementing regulations issued thereunder.

(iii) *Aggregate limit.* The aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired or retained under this section may not exceed 3 percent of the tier 1 capital of the banking entity, as provided under paragraph (c) of this section, and shall be calculated as of the last day of each calendar quarter.

(iv) *Date of establishment.* For purposes of this section, the date of establishment of a covered fund shall be:

(A) *In general.* The date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund;

(B) *Issuing entities of asset-backed securities.* In the case of an issuing entity of asset-backed securities, the date on which the assets are initially transferred into the issuing entity of asset-backed securities.

(b) *Rules of construction*—(1) *Attribution of ownership interests to a covered banking entity.* (i) For purposes of paragraph (a)(2) of this section, the amount and value of a banking entity's permitted investment in any single covered fund shall include any ownership interest held under § 248.12 directly by the banking entity, including any affiliate of the banking entity.

(ii) Treatment of registered investment companies, SEC-regulated business development companies and foreign public funds. For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies or foreign public fund as described in § 248.10(c)(1) of this subpart will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

(iii) *Covered funds.* For purposes of paragraph (b)(1)(i) of this section, a covered fund will not be considered to be an affiliate of a banking entity so long as the covered fund is held in compliance with the requirements of this subpart.

(iv) Treatment of employee and director investments financed by the banking entity. For purposes of paragraph (b)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires an ownership interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(2) *Calculation of permitted ownership interests in a single covered fund.* Except as provided in paragraph (b)(3) or (4), for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(A) of this section:

(i) The aggregate number of the outstanding ownership interests held by the banking entity shall be the total number of ownership interests held under this section by the banking entity in a covered fund divided by the total number of ownership interests held by all entities in that covered fund, as of the last day of each calendar quarter (both measured without regard to committed funds not yet called for investment);

(ii) The aggregate value of the outstanding ownership interests held by the banking entity shall be the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity, divided by the value of all investments in and capital contributions made to that covered fund by all entities, as of the last day of each calendar quarter (all measured without regard to committed funds not yet called for investment). If fair market value cannot be determined, then the value shall be the historical cost basis of all investments in and contributions made by the banking entity to the covered fund;

(iii) For purposes of the calculation under paragraph (b)(2)(ii) of this section, once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards.

(3) *Issuing entities of asset-backed securities.* In the case of an ownership interest in an issuing entity of asset-backed securities, for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(B) of this section:

(i) For securitizations subject to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11), the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder; or

(ii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the calculations shall be made as of the date of establishment as defined in paragraph (a)(2)(iv)(B) of this section or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund, and thereafter only upon the date on which additional securities of the issuing entity of asset-backed securities are priced for purposes of the sales of ownership interests to unaffiliated investors.

(iii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

(iv) For purposes of the calculation under paragraph (b)(3)(iii) of this section, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards.

(4) *Multi-tier fund investments*—(i) *Master-feeder fund investments.* If the principal investment strategy of a covered fund (the ''feeder fund'') is to invest substantially all of its assets in another single covered fund (the ''master fund''), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest of the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments.* If a banking entity organizes and offers a covered fund pursuant to § 248.11 of this subpart for the purpose of investing in other covered funds (a ''fund of funds'') and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest of the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(c) *Aggregate permitted investments in all covered funds.* (1) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 248.10(d)(6)(ii) of this subpart), on a historical cost basis.

(2) *Calculation of tier 1 capital.* For purposes of paragraph (a)(2)(iii) of this section:

(i) *Entities that are required to hold and report tier 1 capital.* If a banking entity is required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be equal to the amount of tier 1 capital of the banking entity as of the last day of the most recent calendar quarter, as reported to its primary financial regulatory agency; and

(ii) If a banking entity is not required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, be equal to the amount of tier 1 capital reported by such controlling depository institution in the manner described in paragraph (c)(2)(i) of this section;

(B) In the case of a banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(*1*) *Bank holding company subsidiaries.* If the banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, be equal to the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital in the manner described in paragraph (c)(2)(i) of this section; and

(*2*) *Other holding companies and any subsidiary or affiliate thereof.* If the banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, be equal to the total amount of shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(iii) *Treatment of foreign banking entities*—(A) *Foreign banking entities.* Except as provided in paragraph (c)(2)(iii)(B) of this section, with respect to a banking entity that is not itself, and is not controlled directly or indirectly by, a banking entity that is located or organized under the laws of the United States or of any State, the tier 1 capital of the banking entity shall be the consolidated tier 1 capital of the entity as calculated under applicable home country standards.

(B) *U.S. affiliates of foreign banking entities.* With respect to a banking entity that is located or organized under the laws of the United States or of any State and is controlled by a foreign banking entity identified under paragraph (c)(2)(iii)(A) of this section, the banking entity's tier 1 capital shall be as calculated under paragraphs (c)(2)(i) or (ii) of this section.

(d) *Capital treatment for a permitted investment in a covered fund.* For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 248.10(d)(6)(ii) of subpart C), on a historical cost basis, plus any earnings received; and

(2) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (b)(3) of this section (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 248.10(d)(6)(ii) of subpart C), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(e) Extension of time to divest an ownership interest. (1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(2) *Factors governing the Board determinations.* In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;

(v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;

(vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;

(vi) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;

(vii) [Reserved]

(viii) Market conditions; and

(ix) Any other factor that the Board believes appropriate.

(3) *Authority to impose restrictions on activities or investment during any extension period.* The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(4) *Consultation.* In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

§ 248.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 248.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund.

(2) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks arising in connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) The compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to this paragraph and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) Certain permitted covered fund activities and investments outside of the United States. (1) The prohibition contained in § 248.10(a) of this subpart does not apply to the acquisition or

retention of any ownership interest in, or the sponsorship of, a covered fund by a banking entity only if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in the covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity or investment occurs solely outside of the United States.

(2) An activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (b)(1)(ii) of this section only if:

(i) The activity or investment is conducted in accordance with the requirements of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of one or more States and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is sold or has been sold pursuant to an offering that does not target residents of the United States.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State;

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and

(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this section, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States; however, a foreign bank of which that branch, agency, or subsidiary is a part is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 248.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

§ 248.14 Limitations on relationships with a covered fund.

(a) Relationships with a covered fund. (1) Except as provided for in paragraph (a)(2) of this section, no 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 § 248.11 of this subpart, or that continues to hold an ownership interest in accordance with § 248.11(b) of this subpart, and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of § 248.11, § 248.12, or § 248.13 of this subpart; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate thereof) has taken an ownership interest, if:

(A) The banking entity is in compliance with each of the limitations set forth in § 248.11 of this subpart with respect to a covered fund organized and offered by such banking entity (or an affiliate thereof);

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually to the Board (with a duty to update the certification if the information in the certification materially changes) 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; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

(b) *Restrictions on transactions with covered funds.* A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § 248.11 of this subpart, or that continues to hold an ownership interest in accordance with § 248.11(b) of this subpart, shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1), as if such banking entity were a member bank and such covered fund were an affiliate thereof.

(c) *Restrictions on prime brokerage transactions.* A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1) as if the counterparty were an affiliate of the banking entity.

§ 248.15 Other limitations on permitted covered fund activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 248.11 through 248.13 of this subpart if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) Definition of high-risk asset and high-risk trading strategy. For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§ 248.16 Ownership of interests in and sponsorship of issuers of certain collateralized debt obligations backed by trust-preferred securities.

(a) The prohibition contained in § 248.10(a)(1) does not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer if:

(1) The issuer was established, and the interest was issued, before May 19, 2010;

(2) The banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral; and

(3) The banking entity acquired such interest on or before December 10, 2013 (or acquired such interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before December 10, 2013).

(b) For purposes of this § 248.16, *Qualifying TruPS Collateral* shall mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument, had total consolidated assets of less than $15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company.

(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 §§ 248.4 and 248.11.

(d) Without limiting the applicability of paragraph (a) of this section, the Board, the FDIC and the OCC will make public a non-exclusive list of issuers that meet the requirements of paragraph (a). A banking entity may rely on the list published by the Board, the FDIC and the OCC.

§§ 248.17–248.19 [Reserved]

Subpart D—Compliance Program Requirement; Violations

§ 248.20 Program for compliance; reporting.

(a) *Program requirement.* 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 this part. The terms, scope and detail of the compliance program shall be appropriate for the types, size, scope and complexity of activities and business structure of the banking entity.

(b) *Contents of compliance program.* Except as provided in paragraph (f) of this section, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities subject to subpart B (including those permitted under §§ 248.3 to 248.6 of subpart B), including setting, monitoring and managing required limits set out in §§ 248.4 and 248.5, and activities and investments with respect to a covered fund subject to subpart C (including those permitted under §§ 248.11 through 248.14 of subpart C) conducted by the banking entity to ensure that all activities and

investments conducted by the banking entity that are subject to section 13 of the BHC Act and this part comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and this part and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in this part or by management as requiring attention;

(4) Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a banking entity must promptly provide to the Board upon request and retain for a period of no less than 5 years or such longer period as required by the Board.

(c) *Additional standards.* In addition to the requirements in paragraph (b) of this section, the compliance program of a banking entity must satisfy the requirements and other standards contained in appendix B, if:

(1) The banking entity engages in proprietary trading permitted under subpart B and is required to comply with the reporting requirements of paragraph (d) of this section;

(2) The banking entity has reported total consolidated assets as of the previous calendar year end of $50 billion or more or, in the case of a foreign banking entity, has total U.S. assets as of the previous calendar year end of $50 billion or more (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States); or

(3) The Board notifies the banking entity in writing that it must satisfy the requirements and other standards contained in appendix B to this part.

(d) *Reporting requirements under appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A, if:

(i) The banking entity (other than a foreign banking entity as provided in paragraph (d)(1)(ii) of this section) has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section;

(ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section; or

(iii) The Board notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A.

(2) The threshold for reporting under paragraph (d)(1) of this section shall be $50 billion beginning on June 30, 2014; $25 billion beginning on April 30, 2016; and $10 billion beginning on December 31, 2016.

(3) Frequency of reporting: Unless the Board notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with paragraph (d)(1) of this section) shall report the information required by appendix A for each calendar month within 30 days of the end of the relevant calendar month; beginning with information for the month of January 2015, such information shall be reported within 10 days of the end of each calendar month. Any other banking entity subject to appendix A shall report the information required by appendix A for each calendar quarter within 30 days of the end of that calendar quarter unless the Board notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* Any banking entity that has more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years shall maintain records that include:

(1) Documentation of the exclusions or exemptions other than sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund;

(2) For each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of covered fund provided by §§ 248.10(c)(1), 248.10(c)(5), 248.10(c)(8), 248.10(c)(9), or 248.10(c)(10) of subpart C, documentation supporting the banking entity's determination that the fund is not a covered fund pursuant to one or more of those exclusions;

(3) For each seeding vehicle described in § 248.10(c)(12)(i) or (iii) of subpart C that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § 248.12(a)(2)(i)(B) of subpart C;

(4) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, if the aggregate amount of ownership interests in foreign public funds that are described in § 248.10(c)(1) of subpart C owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or of any State) exceeds $50 million at the end of two or more consecutive calendar quarters, beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar quarter, which documentation must

continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters; and

(5) For purposes of paragraph (e)(4) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(f) *Simplified programs for less active banking entities*—(1) *Banking entities with no covered activities.* A banking entity that does not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § 248.6(a) of subpart B) may satisfy the requirements of this section by establishing the required compliance program prior to becoming engaged in such activities or making such investments (other than trading activities permitted pursuant to § 248.6(a) of subpart B).

(2) *Banking entities with modest activities.* A banking entity with total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engages in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted under § 248.6(a) of subpart B) may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope and complexity of the banking entity.

§ 248.21 Termination of activities or investments; penalties for violations.

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the Board finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or this part, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or this part, the Board may take any action permitted by law to enforce compliance with section 13 of the BHC Act and this part, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

Appendix A to Part 248—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 248.20(d), this appendix generally applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the Board regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 248.20 and Appendix B.

b. The purpose of this appendix is to assist banking entities and the Board in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 248.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 248.4, 248.5, or 248.6(a)–(b) (*i.e.,* underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the Board of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. The quantitative measurements that must be furnished pursuant to this appendix are *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In order to allow banking entities and the Agencies to evaluate the effectiveness of these metrics, banking entities must collect and report these metrics for all trading desks beginning on the dates established in § 248.20 of the final rule. The Agencies will review the data collected and revise this collection requirement as appropriate based on a review of the data collected prior to September 30, 2015.

e. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 248.20 and Appendix B to this part. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

f. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 248.4 through 248.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the Board, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 248.2 and 248.3. In addition, for purposes of this appendix, the following definitions apply:

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 248.4, 248.5, 248.6(a), or 248.6(b). A banking entity may include trading under §§ 248.3(d), 248.6(c), 248.6(d) or 248.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading desk means 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.

III. Reporting and Recordkeeping of Quantitative Measurements

a. Scope of Required Reporting

General scope. Each banking entity made subject to this part by § 248.20 must furnish the following quantitative measurements for each trading desk of the banking entity, calculated in accordance with this appendix:

- Risk and Position Limits and Usage;
- Risk Factor Sensitivities;
- Value-at-Risk and Stress VaR;
- Comprehensive Profit and Loss Attribution;
- Inventory Turnover;
- Inventory Aging; and
- Customer-Facing Trade Ratio

b. Frequency of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report each applicable quantitative measurement to the Board on the reporting schedule established in § 248.20 unless otherwise requested by the Board. All quantitative measurements for any calendar month must be reported within the time period required by § 248.20.

c. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the Board pursuant to this appendix and § 248.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the Board to verify the accuracy of such reports, for a period of 5 years from the end of the calendar year for which the measurement was taken.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the portion of the trading desk's limits that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited, to the limits set out in § 248.4 and § 248.5. A number of the metrics that are described below, including ''Risk Factor Sensitivities'' and ''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 activities under § 248.4(b) and hedging activity under § 248.5. Accordingly, the limits required under § 248.4(b)(2)(iii) and § 248.5(b)(1)(i) must meet the applicable requirements under § 248.4(b)(2)(iii) and § 248.5(b)(1)(i) and also must include appropriate metrics for the trading desk limits including, at a minimum, the ''Risk Factor Sensitivities'' and ''Value-at-Risk and Stress Value-at-Risk'' metrics except to the extent any of the ''Risk Factor Sensitivities'' or ''Value-at-Risk and Stress Value-at-Risk'' metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

ii. *General Calculation Guidance:* Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached must be reported.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

2. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk.

ii. *General Calculation Guidance:* A banking entity must report the Risk Factor Sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. The underlying data and methods used to compute a trading desk's Risk Factor Sensitivities will depend on the specific function of the trading desk and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading desk, and furnished to the Board, will depend on the explicit risks assumed by the trading desk. In general, however, reported Risk Factor Sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings.

A. Trading desks must take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:

- *Commodity derivative positions:* Risk factors with respect to the related commodities set out in 17 CFR 20.2, the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Credit positions:* Risk factors with respect to credit spreads that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and risk factors with respect to interest rates of all relevant maturities;
- *Credit-related derivative positions:* Risk factor sensitivities, for example credit spreads, shifts (parallel and non-parallel) in credit spreads—volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity derivative positions:* Risk factor sensitivities such as equity positions, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity positions:* Risk factors for equity prices and risk factors that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;
- *Foreign exchange derivative positions:* Risk factors with respect to major currency pairs and maturities, exposure to interest rates at relevant maturities, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and
- *Interest rate positions, including interest rate derivative positions:* Risk factors with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and shifts (parallel and non-parallel) in the interest rate curve, as well as the maturity profile of the positions.

B. The methods used by a banking entity to calculate sensitivities to a common factor shared by multiple trading desks, such as an equity price factor, must be applied consistently across its trading desks so that the sensitivities can be compared from one trading desk to another.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Value-at-Risk and Stress Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the commonly used percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on current market conditions. For purposes of this appendix, Stress Value-at-Risk (''Stress VaR'') is the percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on market conditions during a period of significant financial stress.

ii. *General Calculation Guidance:* Banking entities must compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading desk that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR must be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions''); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (*i.e.,* the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific Risk Factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/ liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

C. The portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *General Calculation Guidance:* The specific categories used by a trading desk in the attribution analysis and amount of detail for the analysis should be tailored to the type and amount of trading activities undertaken by the trading desk. The new position attribution must be computed by calculating the difference between the prices at which instruments were bought and/or sold and the prices at which those instruments are marked to market at the close of business on that day multiplied by the notional or principal amount of each purchase or sale. Any fees, commissions, or other payments received (paid) that are associated with transactions executed on that day must be added (subtracted) from such difference. These factors must be measured consistently over time to facilitate historical comparisons.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

c. Customer-Facing Activity Measurements

1. Inventory Turnover

i. *Description:* For purposes of this appendix, Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period.

ii. *General Calculation Guidance:* For purposes of this appendix, for derivatives, other than options and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

2. Inventory Aging

i. *Description:* For purposes of this appendix, Inventory Aging generally describes a schedule of the trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held. Inventory Aging should measure the age profile of the trading desk's assets and liabilities.

ii. *General Calculation Guidance:* In general, Inventory Aging must be computed using a trading desk's trading activity data and must identify the value of a trading desk's aggregate assets and liabilities. Inventory Aging must include two schedules, an asset-aging schedule and a liability-aging schedule. Each schedule must record the value of assets or liabilities held over all holding periods. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value and, for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Customer-Facing Trade Ratio—Trade Count Based and Value Based

i. *Description:* For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A trade count based ratio must be computed that records the number of transactions involving a counterparty that is a customer of the trading desk and the number of transactions involving a counterparty that is not a customer of the trading desk. A value based ratio must be computed that records the value of transactions involving a counterparty that is a customer of the trading desk and the value of transactions involving a counterparty that is not a customer of the trading desk.

ii. *General Calculation Guidance:* For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 248.20(d)(1) unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

Appendix B to Part 248—Enhanced Minimum Standards for Compliance Programs

I. Overview

Section 248.20(c) requires certain banking entities to establish, maintain, and enforce an enhanced compliance program that includes the requirements and standards in this Appendix as well as the minimum written policies and procedures, internal controls, management framework, independent testing, training, and recordkeeping provisions outlined in § 248.20. This Appendix sets forth additional minimum standards with respect to the establishment, oversight, maintenance, and enforcement by these banking entities of an enhanced internal compliance program for ensuring and monitoring 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 this part.

a. This compliance program must:

1. Be reasonably designed to identify, document, monitor, and report the permitted trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these covered activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and this part;

2. Establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and this part;

3. Subject the effectiveness of the compliance program to periodic independent review and testing, and ensure that the entity's internal audit, corporate compliance and internal control functions involved in review and testing are effective and independent;

4. Make senior management, and others as appropriate, accountable for the effective implementation of the compliance program, and ensure that the board of directors and chief executive officer (or equivalent) of the banking entity review the effectiveness of the compliance program; and

5. Facilitate supervision and examination by the Agencies of the banking entity's permitted trading and covered fund activities and investments.

II. Enhanced Compliance Program

a. *Proprietary Trading Activities.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, and complexity of, and risks associated with, its permitted trading activities. The compliance program may be tailored to the types of trading activities conducted by the banking entity, and must include a detailed description of controls established by the banking entity to reasonably ensure that its trading activities are conducted in accordance with the requirements and limitations applicable to those trading activities under section 13 of the BHC Act and this part, and provide for appropriate revision of the compliance program before expansion of the trading activities of the banking entity. A banking entity must devote adequate resources and use knowledgeable personnel in conducting, supervising and managing its trading activities, and promote consistency, independence and rigor in implementing its risk controls and compliance efforts. The compliance program must be updated with a frequency sufficient to account for changes in the activities of the banking entity, results of independent testing of the program, identification of weaknesses in the program, and changes in legal, regulatory or other requirements.

1. *Trading Desks:* The banking entity must have written policies and procedures governing each trading desk that include a description of:

i. The process for identifying, authorizing and documenting financial instruments each trading desk may purchase or sell, with separate documentation for market making-related activities conducted in reliance on §248.4(b) and for hedging activity conducted in reliance on § 248.5;

ii. A mapping for each trading desk to the division, business line, or other organizational structure that is responsible for managing and overseeing the trading desk's activities;

iii. The mission (*i.e.,* the type of trading activity, such as market-making, trading in sovereign debt, etc.) and strategy (*i.e.,* methods for conducting authorized trading activities) of each trading desk;

iv. The activities that the trading desk is authorized to conduct, including (i) authorized instruments and products, and (ii) authorized hedging strategies, techniques and instruments;

v. The types and amount of risks allocated by the banking entity to each trading desk to implement the mission and strategy of the trading desk, including an enumeration of material risks resulting from the activities in which the trading desk is authorized to engage (including but not limited to price risks, such as basis, volatility and correlation risks, as well as counterparty credit risk). Risk assessments must take into account both the risks inherent in the trading activity and the strength and effectiveness of controls designed to mitigate those risks;

vi. How the risks allocated to each trading desk will be measured;

vii. Why the allocated risks levels are appropriate to the activities authorized for the trading desk;

viii. The limits on the holding period of, and the risk associated with, financial instruments under the responsibility of the trading desk;

ix. The process for setting new or revised limits, as well as escalation procedures for granting exceptions to any limits or to any policies or procedures governing the desk, the analysis that will be required to support revising limits or granting exceptions, and the process for independently reviewing and documenting those exceptions and the underlying analysis;

x. The process for identifying, documenting and approving new products, trading strategies, and hedging strategies;

xi. The types of clients, customers, and counterparties with whom the trading desk may trade; and

xii. The compensation arrangements, including incentive arrangements, for employees associated with the trading desk, which may not be designed to reward or incentivize prohibited proprietary trading or excessive or imprudent risk-taking.

2. *Description of risks and risk management processes:* The compliance program for the banking entity must include a comprehensive description of the risk management program for the trading activity of the banking entity. The compliance program must also include a description of the governance, approval, reporting, escalation, review and other processes the banking entity will use to reasonably ensure that trading activity is conducted in compliance with section 13 of the BHC Act and this part. Trading activity in similar financial instruments should be subject to similar governance, limits, testing, controls, and review, unless the banking entity specifically determines to establish different limits or processes and documents those differences. Descriptions must include, at a minimum, the following elements:

i. A description of the supervisory and risk management structure governing all trading activity, including a description of processes for initial and senior-level review of new products and new strategies;

ii. A description of the process for developing, documenting, testing, approving and reviewing all models used for valuing, identifying and monitoring the risks of trading activity and related positions, including the process for periodic independent testing of the reliability and accuracy of those models;

iii. A description of the process for developing, documenting, testing, approving and reviewing the limits established for each trading desk;

iv. A description of the process by which a security may be purchased or sold pursuant to the liquidity management plan, including the process for authorizing and monitoring such activity to ensure compliance with the banking entity's liquidity management plan and the restrictions on liquidity management activities in this part;

v. A description of the management review process, including escalation procedures, for approving any temporary exceptions or permanent adjustments to limits on the activities, positions, strategies, or risks associated with each trading desk; and

vi. The role of the audit, compliance, risk management and other relevant units for conducting independent testing of trading and hedging activities, techniques and strategies.

3. *Authorized risks, instruments, and products.* The banking entity must implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that trading activity is conducted in conformance with section 13 of the BHC Act and this part and with the banking entity's written policies and procedures. The banking entity must establish and enforce risk limits appropriate for the activity of each trading desk. These limits should be based on probabilistic and non-probabilistic measures of potential loss (*e.g.,* Value-at-Risk and notional exposure, respectively), and measured under normal and stress market conditions. At a minimum, these internal controls must monitor, establish and enforce limits on:

i. The financial instruments (including, at a minimum, by type and exposure) that the trading desk may trade;

ii. The types and levels of risks that may be taken by each trading desk; and

iii. The types of hedging instruments used, hedging strategies employed, and the amount of risk effectively hedged.

4. *Hedging policies and procedures.* The banking entity must establish, maintain, and enforce written policies and procedures

regarding the use of risk-mitigating hedging instruments and strategies that, at a minimum, describe:

i. The positions, techniques and strategies that each trading desk may use to hedge the risk of its positions;

ii. The manner in which the banking entity will identify the risks arising in connection with and related to the individual or aggregated positions, contracts or other holdings of the banking entity that are to be hedged and determine that those risks have been properly and effectively hedged;

iii. The level of the organization at which hedging activity and management will occur;

iv. The manner in which hedging strategies will be monitored and the personnel responsible for such monitoring;

v. The risk management processes used to control unhedged or residual risks; and

vi. The process for developing, documenting, testing, approving and reviewing all hedging positions, techniques and strategies permitted for each trading desk and for the banking entity in reliance on § 248.5.

5. *Analysis and quantitative measurements.* The banking entity must perform robust analysis and quantitative measurement of its trading activities that is reasonably designed to ensure that the trading activity of each trading desk is consistent with the banking entity's compliance program; monitor and assist in the identification of potential and actual prohibited proprietary trading activity; and prevent the occurrence of prohibited proprietary trading. Analysis and models used to determine, measure and limit risk must be rigorously tested and be reviewed by management responsible for trading activity to ensure that trading activities, limits, strategies, and hedging activities do not understate the risk and exposure to the banking entity or allow prohibited proprietary trading. This review should include periodic and independent back-testing and revision of activities, limits, strategies and hedging as appropriate to contain risk and ensure compliance. In addition to the quantitative measurements reported by any banking entity subject to Appendix A to this part, each banking entity must develop and implement, to the extent appropriate to facilitate compliance with this part, additional quantitative measurements specifically tailored to the particular risks, practices, and strategies of its trading desks. The banking entity's analysis and quantitative measurements must incorporate the quantitative measurements reported by the banking entity pursuant to Appendix A (if applicable) and include, at a minimum, the following:

i. Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of quantitative measurements;

ii. Ongoing, timely monitoring and review of calculated quantitative measurements;

iii. The establishment of numerical thresholds and appropriate trading measures for each trading desk and heightened review of trading activity not consistent with those thresholds to ensure compliance with section 13 of the BHC Act and this part, including analysis of the measurement results or other information, appropriate escalation procedures, and documentation related to the review; and

iv. Immediate review and compliance investigation of the trading desk's activities, escalation to senior management with oversight responsibilities for the applicable trading desk, timely notification to the Board, appropriate remedial action (*e.g.,* divesting of impermissible positions, cessation of impermissible activity, disciplinary actions), and documentation of the investigation findings and remedial action taken when quantitative measurements or other information, considered together with the facts and circumstances, or findings of internal audit, independent testing or other review suggest a reasonable likelihood that the trading desk has violated any part of section 13 of the BHC Act or this part.

6. *Other Compliance Matters.* In addition to the requirements specified above, the banking entity's compliance program must:

i. Identify activities of each trading desk that will be conducted in reliance on exemptions contained in §§ 248.4 through 248.6, including an explanation of:

A. How and where in the organization the activity occurs; and

B. Which exemption is being relied on and how the activity meets the specific requirements for reliance on the applicable exemption;

ii. Include an explanation of the process for documenting, approving and reviewing actions taken pursuant to the liquidity management plan, where in the organization this activity occurs, the securities permissible for liquidity management, the process for ensuring that liquidity management activities are not conducted for the purpose of prohibited proprietary trading, and the process for ensuring that securities purchased as part of the liquidity management plan are highly liquid and conform to the requirements of this part;

iii. Describe how the banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each trading desk that relies on the exemptions contained in §§ 248.3(d)(3), and 248.4 through 248.6, which must take into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in value cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that result in large and significant concentrations to sectors, risk factors, or counterparties;

iv. Establish responsibility for compliance with the reporting and recordkeeping requirements of subpart B and § 248.20; and

v. Establish policies for monitoring and prohibiting potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties.

7. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any trading activity that may indicate potential violations of section 13 of the BHC Act and this part and to prevent actual violations of section 13 of the BHC Act and this part. The compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

b. *Covered Fund Activities or Investments.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, complexity and risks of the covered fund and related activities conducted and investments made, by the banking entity.

1. *Identification of covered funds.* The banking entity's compliance program must provide a process, which must include appropriate management review and independent testing, for identifying and documenting covered funds that each unit within the banking entity's organization sponsors or organizes and offers, and covered funds in which each such unit invests. In addition to the documentation requirements for covered funds, as specified under § 248.20(e), the documentation must include information that identifies all pools that the banking entity sponsors or has an interest in and the type of exemption from the Commodity Exchange Act (whether or not the pool relies on section 4.7 of the regulations under the Commodity Exchange Act), and the amount of ownership interest the banking entity has in those pools.

2. *Identification of covered fund activities and investments.* The banking entity's compliance program must identify, document and map each unit within the organization that is permitted to acquire or hold an interest in any covered fund or sponsor any covered fund and map each unit to the division, business line, or other organizational structure that will be

responsible for managing and overseeing that unit's activities and investments.

3. *Explanation of compliance.* The banking entity's compliance program must explain how:

i. The banking entity monitors for and prohibits potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties related to its covered fund activities and investments;

ii. The banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the banking entity related to its covered fund activities and investments; and

iii. The banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by its covered fund activities and investments, taking into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in values cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that expose the banking entity to large and significant concentrations with respect to sectors, risk factors, or counterparties;

4. *Description and documentation of covered fund activities and investments.* For each organizational unit engaged in covered fund activities and investments, the banking entity's compliance program must document:

i. The covered fund activities and investments that the unit is authorized to conduct;

ii. The banking entity's plan for actively seeking unaffiliated investors to ensure that any investment by the banking entity conforms to the limits contained in § 248.12 or registered in compliance with the securities laws and thereby exempt from those limits within the time periods allotted in§ 248.12; and

iii. How it complies with the requirements of subpart C.

5. *Internal Controls.* A banking entity must establish, maintain, and enforce internal controls that are reasonably designed to ensure that its covered fund activities or investments comply with the requirements of section 13 of the BHC Act and this part and are appropriate given the limits on risk established by the banking entity. These written internal controls must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part. The internal controls must, at a minimum require:

i. Monitoring and limiting the banking entity's individual and aggregate investments in covered funds;

ii. Monitoring the amount and timing of seed capital investments for compliance with the limitations under subpart C (including but not limited to the redemption, sale or disposition requirements) of § 248.12, and the effectiveness of efforts to seek unaffiliated investors to ensure compliance with those limits;

iii. Calculating the individual and aggregate levels of ownership interests in one or more covered fund required by § 248.12;

iv. Attributing the appropriate instruments to the individual and aggregate ownership interest calculations above;

v. Making disclosures to prospective and actual investors in any covered fund organized and offered or sponsored by the banking entity, as provided under § 248.11(a)(8);

vi. Monitoring for and preventing any relationship or transaction between the banking entity and a covered fund that is prohibited under § 248.14, including where the banking entity has been designated as the sponsor, investment manager, investment adviser, or commodity trading advisor to a covered fund by another banking entity; and

vii. Appropriate management review and supervision across legal entities of the banking entity to ensure that services and products provided by all affiliated entities comply with the limitation on services and products contained in § 248.14.

6. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part and to prevent actual violations of section 13 of the BHC Act and this part. The banking entity's compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, including § 248.21, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity or investment indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

III. Responsibility and Accountability for the Compliance Program

a. A banking entity must establish, maintain, and enforce a governance and management framework to manage its business and employees with a view to preventing violations of section 13 of the BHC Act and this part. A banking entity must have an appropriate management framework reasonably designed to ensure that: Appropriate personnel are responsible and accountable for the effective implementation and enforcement of the compliance program; a clear reporting line with a chain of responsibility is delineated; and the compliance program is reviewed periodically by senior management. The board of directors (or equivalent governance body) and senior management should have the appropriate authority and access to personnel and information within the organizations as well as appropriate resources to conduct their oversight activities effectively.

1. *Corporate governance.* The banking entity must adopt a written compliance program approved by the board of directors, an appropriate committee of the board, or equivalent governance body, and senior management.

2. *Management procedures.* The banking entity must establish, maintain, and enforce a governance framework that is reasonably designed to achieve compliance with section 13 of the BHC Act and this part, which, at a minimum, provides for:

i. The designation of appropriate senior management or committee of senior management with authority to carry out the management responsibilities of the banking entity for each trading desk and for each organizational unit engaged in covered fund activities;

ii. Written procedures addressing the management of the activities of the banking entity that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, including:

A. A description of the management system, including the titles, qualifications, and locations of managers and the specific responsibilities of each person with respect to the banking entity's activities governed by section 13 of the BHC Act and this part; and

B. Procedures for determining compensation arrangements for traders engaged in underwriting or market making-related activities under § 248.4 or risk-mitigating hedging activities under § 248.5 so that such compensation arrangements are designed not to reward or incentivize prohibited proprietary trading and appropriately balance risk and financial results in a manner that does not encourage employees to expose the banking entity to excessive or imprudent risk.

3. *Business line managers.* Managers with responsibility for one or more trading desks of the banking entity are accountable for the effective implementation and enforcement of the compliance program with respect to the applicable trading desk(s).

4. *The Board of directors, or similar corporate body, and senior management.* The board of directors, or similar corporate body, and senior management are responsible for setting and communicating an appropriate culture of compliance with section 13 of the BHC Act and this part and ensuring that appropriate policies regarding the management of trading activities and covered fund activities or investments are adopted to comply with section 13 of the BHC Act and

this part. The board of directors or similar corporate body (such as a designated committee of the board or an equivalent governance body) must ensure that senior management is fully capable, qualified, and properly motivated to manage compliance with this part in light of the organization's business activities and the expectations of the board of directors. The board of directors or similar corporate body must also ensure that senior management has established appropriate incentives and adequate resources to support compliance with this part, including the implementation of a compliance program meeting the requirements of this appendix into management goals and compensation structures across the banking entity.

5. *Senior management.* Senior management is responsible for implementing and enforcing the approved compliance program. Senior management must also ensure that effective corrective action is taken when failures in compliance with section 13 of the BHC Act and this part are identified. Senior management and control personnel charged with overseeing compliance with section 13 of the BHC Act and this part should review the compliance program for the banking entity periodically and report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading activities and covered fund activities or investments, which shall be at least annually.

6. *CEO attestation.* Based on a review by the CEO of the banking entity, the CEO of the banking entity must, annually, attest in writing to the Board that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under this Appendix and § 248.20 of this part in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the United States operations of the foreign banking entity who is located in the United States.

IV. Independent Testing

a. Independent testing must occur with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading and covered fund activities or investments, which shall be at least annually. This independent testing must include an evaluation of:

1. The overall adequacy and effectiveness of the banking entity's compliance program, including an analysis of the extent to which the program contains all the required elements of this appendix;

2. The effectiveness of the banking entity's internal controls, including an analysis and documentation of instances in which such internal controls have been breached, and how such breaches were addressed and resolved; and

3. The effectiveness of the banking entity's management procedures.

b. A banking entity must ensure that independent testing regarding the effectiveness of the banking entity's compliance program is conducted by a qualified independent party, such as the banking entity's internal audit department, compliance personnel or risk managers independent of the organizational unit being tested, outside auditors, consultants, or other qualified independent parties. A banking entity must promptly take appropriate action to remedy any significant deficiencies or material weaknesses in its compliance program and to terminate any violations of section 13 of the BHC Act or this part.

V. Training

Banking entities must provide adequate training to personnel and managers of the banking entity engaged in activities or investments governed by section 13 of the BHC Act or this part, as well as other appropriate supervisory, risk, independent testing, and audit personnel, in order to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the banking entity's trading activities and covered fund activities or investments.

VI. Recordkeeping

Banking entities must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A banking entity must retain these records for a period that is no less than 5 years or such longer period as required by the Board in a form that allows it to promptly produce such records to the Board on request.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter I

Authority and Issuance

For the reasons stated in the Common Preamble, the Federal Deposit Insurance Corporation amends chapter III of Title 12, Code of Federal Regulations as follows:

PART 351—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 31. The authority citation for part 351 continues to read as follows:

Authority: 12 U.S.C. 1851; 1811 *et seq.;* 3101 *et seq.;* and 5412.

Subpart A—Authority and Definitions

■ 32. Section 351.2 is revised to read as follows:

§ 351.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraph (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(vii) A covered fund that is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section;

(viii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section; or

(ix) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in § 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Limited trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 351.6(a)(1) and (2) of subpart B) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion; and

(ii) The FDIC has not determined pursuant to § 351.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (s)(3) of this section, trading assets and liabilities for purposes of this paragraph (s) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 351.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (s) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 351.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

(ii) For purposes of paragraph (s)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (s)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States, including branches outside the United States that are managed or controlled by a U.S. branch or agency of the foreign banking organization, for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(t) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(u) *Moderate trading assets and liabilities* means, with respect to a banking entity, that the banking entity does not have significant trading assets and liabilities or limited trading assets and liabilities.

(v) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(w) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(x) Qualifying foreign banking organization means a foreign banking organization that qualifies as such under § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(y) *SEC* means the Securities and Exchange Commission.

(z) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(aa) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(bb) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(cc) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(dd) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(ee) *Significant trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $20 billion; or

(ii) The FDIC has determined pursuant to § 351.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity, other than a banking entity described in paragraph (ee)(3) of this section, trading assets and liabilities for purposes of this paragraph (ee) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 351.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (ee) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 351.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States as well as branches outside the United States that are managed or controlled by a branch or agency of the foreign banking entity operating, located or organized in the United States).

(ii) For purposes of paragraph (ee)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (ee)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(ff) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(gg) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(hh) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ii) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

■ 33. Section 351.3 is amended by:

■ a. Revising paragraphs (b) and (d)(3), (8), and (9);

■ b. Adding paragraphs (d)(10) through (13);

■ c. Redesignating paragraphs (e)(5) through (13) as paragraphs (e)(6) through (14);

■ d. Adding new paragraph (e)(5); and

■ e. Revising redesignated paragraphs (e)(11), (12), and (14).

The revisions and additions read as follows:

§ 351.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account.* (1) *Trading account.* Trading account means:

(i) Any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from the purchases or sales of financial instruments described in this paragraph;

(ii) Any account that is used by a banking entity to purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, 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; or

(iii) Any account that is used by a banking entity to purchase or sell one or more financial instruments, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Trading account application for certain banking entities.* (i) A banking entity that is subject to paragraph (b)(1)(ii) of this section in determining the scope of its trading account is not subject to paragraph (b)(1)(i) of this section.

(ii) A banking entity that does not calculate risk-based capital ratios under the market risk capital rule and is not a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk based capital ratios under the market risk capital rule may elect to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph. A banking entity that elects under this subsection to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph is not required to apply paragraph (b)(1)(i) of this section.

(3) Consistency of account election for certain banking entities. (i) Any election

or change to an election under paragraph (b)(2)(ii) of this section must apply to the electing banking entity and all of its wholly owned subsidiaries. The primary financial regulatory agency of a banking entity that is affiliated with but is not a wholly owned subsidiary of such electing banking entity may require that the banking entity be subject to this uniform application requirement if the primary financial regulatory agency determines that it is necessary to prevent evasion of the requirements of this part after notice and opportunity for response as provided in subpart D of this part.

(ii) A banking entity that does not elect under paragraph (b)(2)(ii) of this section to be subject to the trading account definition in (b)(1)(ii) of this section may continue to apply the trading account definition in paragraph (b)(1)(i) of this section for one year from the date on which it becomes, or becomes a consolidated affiliate for regulatory reporting purposes with, a banking entity that calculates risk-based capital ratios under the market risk capital rule.

(4) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed not to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for sixty days or longer and does not transfer substantially all of the risk of the financial instrument within sixty days of the purchase (or sale).

* * * * *

(d) * * *

(3) Any purchase or sale of a security, foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), or cross-currency swap by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular financial instruments to be used for liquidity management purposes, the amount, types, and risks of these financial instruments that are consistent with liquidity management, and the liquidity circumstances in which the particular financial instruments may or must be used;

(ii) Requires that any purchase or sale of financial instruments contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any financial instruments purchased or sold for liquidity management purposes be highly liquid and limited to financial instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any financial instruments purchased or sold for liquidity management purposes, together with any other financial instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under § 351.6(a) or (b) of this subpartare for the purpose of liquidity management and in accordance with the liquidity management plan described in this paragraph (d)(3); and

(vi) Is consistent with the FDIC's regulatory requirements regarding liquidity management;

* * * * *

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity;

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the FDIC;

(10) Any purchase or sale of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error;

(11) Contemporaneously entering into a customer-driven swap or customer-driven security-based swap and a matched swap or security-based swap if:

(i) The banking entity retains no more than minimal price risk; and

(ii) The banking entity is not a registered dealer, swap dealer, or security-based swap dealer;

(12) Any purchase or sale of one or more financial instruments that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy; or

(13) Any purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form for a banking entity as of January 1, 2020.

(e) * * *

(5) *Cross-currency swap* means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

* * * * *

(11) *Market risk capital rule covered position and trading position* means a financial instrument that meets the criteria to be a covered position and a trading position, as those terms are respectively defined, without regard to whether the financial instrument is reported as a covered position or trading position on any applicable regulatory reporting forms:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(12) *Market risk capital rule* means the market risk capital rule that is contained in 12 CFR part 3, subpart F, with respect to a banking entity for which the OCC is the primary financial regulatory agency, 12 CFR part 217 with

respect to a banking entity for which the Board is the primary financial regulatory agency, or 12 CFR part 324 with respect to a banking entity for which the FDIC is the primary financial regulatory agency.

* * * * *

(14) *Trading desk* means a 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 that is:

(i)(A) Structured by the banking entity to implement a well-defined business strategy;

(B) Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies; and

(C) Characterized by a clearly defined unit that:

(1) Engages in coordinated trading activity with a unified approach to its key elements;

(2) Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;

(3) Submits compliance reports and other information as a unit for monitoring by management; and

(4) Books its trades together; or

(ii) For a banking entity that calculates risk-based capital ratios under the market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the market risk capital rule.

■ 34. Section 351.4 is revised to read as follows:

§ 351.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 351.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii)(A) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities; and

(B) Reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this paragraph (a), including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with paragraph (a)(2)(ii)(A) of this section;

(C) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (a)(2)(iii)(B) and (C) of this section by complying with the requirements set forth in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a *distribution* of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this section, *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 351.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure, routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The trading desk's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, in accordance with paragraph (b)(2)(ii) of this section;

(D) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(E) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (b)(2)(iii)(C) and (D) of this section by complying with the requirements set forth in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with the methodology described in § 351.2(ee) of this part, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(ii) [Reserved]

(4) *Definition of financial exposure.* For purposes of this section, *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker positions.* For the purposes of this section, *market-maker positions* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

(c) *Rebuttable presumption of compliance*—(1) *Internal limits.* (i) A banking entity shall be presumed to meet the requirement in paragraph (a)(2)(ii)(A) or (b)(2)(ii) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the internal limits for the relevant trading desk as described in paragraph (c)(1)(ii) of this section.

(ii)(A) With respect to underwriting activities conducted pursuant to paragraph (a) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of securities and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's underwriting activities, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held.

(B) With respect to market making-related activities conducted pursuant to paragraph (b) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's market-making related activities, that address the:

(*1*) Amount, types, and risks of its market-maker positions;

(*2*) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) Level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) Period of time a financial instrument may be held.

(2) *Supervisory review and oversight.* The limits described in paragraph (c)(1) of this section shall be subject to supervisory review and oversight by the FDIC on an ongoing basis.

(3) *Limit Breaches and Increases.* (i) With respect to any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, a banking entity shall maintain and make available to the FDIC upon request records regarding:

(A) Any limit that is exceeded; and

(B) Any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the FDIC.

(ii) In the event of a breach or increase of any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, the presumption described in paragraph (c)(1)(i) of this section shall continue to be available only if the banking entity:

(A) Takes action as promptly as possible after a breach to bring the trading desk into compliance; and

(B) Follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval.

(4) *Rebutting the presumption.* The presumption in paragraph (c)(1)(i) of this section may be rebutted by the FDIC if the FDIC determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The FDIC's rebuttal of the presumption in paragraph (c)(1)(i) must be made in accordance with the notice and response procedures in subpart D of this part.

■ 35. Section 351.5 is amended by revising paragraphs (b) and (c)(1) and adding paragraph (c)(4) to read as follows:

§ 351.5 Permitted risk-mitigating hedging activities.

* * * * *

(b) * * *

(1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * *

(1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

■ 36. Section 351.6 is amended by revising paragraph (e)(3); removing paragraphs (e)(4) and (6); and redesignating paragraph (e)(5) as paragraph (e)(4).

The revisions reads as follows:

§ 351.6 Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including relevant personnel) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

Subpart C—Covered Funds Activities and Investments

■ 37. Section 351.10 is amended by revising paragraphs (c)(7)(ii) and (c)(8)(i)(A) to read as follows:

§ 351.10 Prohibition on Acquiring or Retaining an Ownership Interest in and Having Certain Relationships with a Covered Fund.

* * * * *

(c) * * *

(7) * * *

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable requirements regarding bank owned life insurance.

(8) * * *

(i) * * *

(A) Loans as defined in § 351.2(t) of subpart A;

* * * * *

■ 38. Section 351.11 is amended by revising paragraph (c) to read as follows:

§ 351.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 351.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 351.4(a) or (b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78*o*–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 351.12(a)(2)(ii) and (iii) and (d) of this subpart.

§ 351.12 [Amended]

■ 39. Section 351.12 is amended by redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

■ 40. Section 351.13 is amended by revising paragraphs (a), (b)(3) and (4), and (c) to read as follows:

§ 351.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 351.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program in accordance with subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising:

(*1*) Out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund; or

(*2*) In connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) With respect to risk-mitigating hedging activity conducted pursuant to paragraph (a)(1)(i) of this section, the compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to paragraph (a)(1)(i) and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) * * *

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of this paragraph (b)(3) to participate in any offer or sale by the covered fund of ownership interests in the covered fund.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

(c) *Permitted covered fund interests and activities by a regulated insurance company.* The prohibition contained in § 351.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws and regulations of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law or regulation described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

■ 41. Section 351.14 is amended by revising paragraph (a)(2)(ii)(B) to read as follows:

§ 351.14 Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the FDIC (with a duty to update the certification if the information in the certification materially changes) 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; and

* * * * *

Subpart D—Compliance Program Requirement; Violations

■ 42. Section 351.20 is amended by revising paragraphs (a), (b) introductory text, (c), (d), (e) introductory text, and (f)(2) and adding paragraphs (g), (h), and (i) to read as follows:

§ 351.20 Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) 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 this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities.* With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation.* The CEO of a banking entity that has significant trading assets and liabilities must, based on a review by the CEO of the banking entity, attest in writing to the FDIC, each year no later than March 31, that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program required by paragraph (b) of this section in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States.

(d) *Reporting requirements under appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in appendix A to this part, if:

(i) The banking entity has significant trading assets and liabilities; or

(ii) The FDIC notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A to this part.

(2) Frequency of reporting: Unless the FDIC notifies the banking entity in writing that it must report on a different basis, a banking entity subject to appendix A to this part shall report the information required by appendix A for each quarter within 30 days of the end of the quarter.

(e) *Additional documentation for covered funds.* A banking entity with significant trading assets and liabilities shall maintain records that include:

* * * * *

(f) * * *

(2) *Banking entities with moderate trading assets and liabilities.* A banking entity with moderate trading assets and liabilities may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.

(g) Rebuttable presumption of compliance for banking entities with limited trading assets and liabilities—(1) *Rebuttable presumption.* Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities shall be presumed to be compliant with subpart B and subpart C of this part and shall have no obligation to demonstrate compliance with this part on an ongoing basis.

(2) *Rebuttal of presumption.* If upon examination or audit, the FDIC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C of this part, the FDIC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities. The FDIC's rebuttal of the presumption in this paragraph must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the FDIC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the FDIC determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C of this part, does not warrant a presumption of compliance under paragraph (g) of this section or treatment as a banking entity with moderate trading assets and liabilities, as applicable. The FDIC's exercise of this reservation of authority must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(i) *Notice and response procedures*—(1) *Notice.* The FDIC will notify the banking entity in writing of any determination requiring notice under this part and will provide an explanation of the determination.

(2) *Response.* The banking entity may respond to any or all items in the notice described in paragraph (i)(1) of this section. The response should include any matters that the banking entity would have the FDIC consider in deciding whether to make the determination. The response must be in writing and delivered to the designated FDIC official within 30 days after the date on which the banking entity received the notice. The FDIC may shorten the time period when, in the opinion of the FDIC, the activities or condition of the banking entity so requires, provided that the banking entity is informed of the time period at the time of notice, or with the consent of the banking entity. In its discretion, the FDIC may extend the time period for good cause.

(3) *Waiver.* Failure to respond within 30 days or such other time period as may be specified by the FDIC shall constitute a waiver of any objections to the FDIC determination.

(4) *Decision.* The FDIC will notify the banking entity of the decision in writing. The notice will include an explanation of the decision.

■ 43. Revise appendix A to part 351 to read as follows:

Appendix A to Part 351—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 351.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the FDIC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 351.20.

b. The purpose of this appendix is to assist banking entities and the FDIC in:

(1) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(2) Monitoring the banking entity's covered trading activities;

(3) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(4) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 351.4(b) are consistent with the requirements governing permitted market making-related activities;

(5) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to § 351.4, § 351.5, or § 351.6(a) and (b) (*i.e.,* underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(6) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the FDIC of such activities; and

(7) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is not intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 351.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 351.4 through 351.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the FDIC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 351.2 and 351.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under § 351.4, § 351.5, § 351.6(a), or § 351.6(b). A banking entity may include in its covered trading activity trading conducted under § 351.3(d), § 351.6(c), § 351.6(d) or § 351.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. Quantitative measurements. Each banking entity made subject to this appendix by § 351.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Internal Limits and Usage;

ii. Value-at-Risk;

iii. Comprehensive Profit and Loss Attribution;

iv. Positions; and

v. Transaction Volumes.

2. Trading desk information. Each banking entity made subject to this appendix by § 351.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. Quantitative measurements identifying information. Each banking entity made subject to this appendix by § 351.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. Narrative statement. Each banking entity made subject to this appendix by § 351.20 may provide an optional narrative statement, as further described in this appendix.

5. File identifying information. Each banking entity made subject to this appendix by § 351.20 must provide file identifying information in each submission to the FDIC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. Trading Desk Information

1. Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

i. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;

ii. Identification of each type of covered trading activity in which the trading desk is engaged;

iii. Brief description of the general strategy of the trading desk;

v. A list identifying each Agency receiving the submission of the trading desk;

2. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and

3. Currency reported and daily currency conversion rate.

c. Quantitative Measurements Identifying Information

Each banking entity must provide the following information regarding the quantitative measurements:

1. An Internal Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Internal Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, the unit of measurement for the limit, the type of limit, and identification of the corresponding risk factor attribution in the particular case that the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and

2. A Risk Factor Attribution Information Schedule that provides identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement, including the name of the risk factor or other factor, a unique identification label for the risk factor or other factor, a description of the risk factor or other factor, and the risk factor or other factor's change unit.

d. Narrative Statement

Each banking entity made subject to this appendix by § 351.20 may submit in a separate electronic document a Narrative Statement to the FDIC with any information the banking entity views as relevant for assessing the information reported. The Narrative Statement may include further description of or changes to calculation methods, identification of material events, description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such changes occurred.

e. Frequency and Method of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the FDIC on the reporting schedule established in § 351.20 unless otherwise requested by the FDIC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the FDIC in accordance with the XML Schema specified and published on the FDIC's website.

f. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the FDIC pursuant to this appendix and § 351.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the FDIC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the FDIC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Internal Limits and Usage

i. *Description:* For purposes of this appendix, Internal Limits are 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. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Internal limits and their usage are key compliance and risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in §§ 351.4 and 351.5. A trading desk's risk limits, commonly including a limit on ''Value-at-Risk,'' are useful in the broader context of the trading desk's overall activities, particularly for the market making activities under § 351.4(b) and hedging activity under § 351.5. Accordingly, the limits required under §§ 351.4(b)(2)(iii)(C) and 351.5(b)(1)(i)(A) must meet the applicable requirements under §§ 351.4(b)(2)(iii)(C) and 351.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, ''Value-at-Risk'' except to the extent the ''Value-at-Risk'' metric is demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

A. A banking entity must provide the following information for each limit reported pursuant to this quantitative measurement: The unique identification label for the limit reported in the Internal Limits Information Schedule, the limit size (distinguishing between an upper and a lower limit), and the value of usage of the limit.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

2. Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the measurement of the risk of future financial loss in the value of a trading desk's aggregated positions at the ninety-nine percent confidence level over a one-day period, based on current market conditions.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into two categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); and (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions'').

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to (i) changes in the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. For the attribution of comprehensive profit and loss from existing positions to specific risk factors and other factors, a banking entity must provide the following information for the factors that explain the preponderance of the profit or loss changes due to risk factor changes: The unique identification label for the risk factor or other factor listed in the Risk Factor Attribution Information Schedule, and the profit or loss due to the risk factor or other factor change.

C. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

D. The portion of comprehensive profit and loss from existing positions that is not attributed to changes in specific risk factors and other factors must be allocated to a residual category. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

c. Positions and Transaction Volumes Measurements

1. Positions

i. *Description:* For purposes of this appendix, Positions is the value of securities and derivatives positions managed by the trading desk. For purposes of the Positions quantitative measurement, do not include in the Positions calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [1225] A banking entity must separately report the trading desk's market value of long securities positions, short securities positions, derivatives receivables, and derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 351.4(a) or § 351.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description:* For purposes of this appendix, Transaction Volumes measures three exclusive categories of covered trading activity conducted by a trading desk. A banking entity is required to report the value and number of security and derivative transactions conducted by the trading desk with: (i) Customers, excluding internal transactions; (ii) non-customers, excluding internal transactions; and (iii) trading desks and other organizational units where the transaction is booked into either the same banking entity or an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [1226] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 351.4(a) to conduct underwriting activity is a market participant identified in § 351.4(a)(7), and a customer of a trading desk that relies on § 351.4(b) to conduct market making-related activity is a market participant identified in § 351.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 351.4(a) or § 351.4(b) to conduct underwriting activity or market-making-related activity, respectively.

Appendix B to Part 351 [Removed]

■ 44. Appendix B to part 351 is removed.

■ 45. Effective January 1, 2020 until December 31, 2020, appendix Z to part 351 is added to read as follows:

Appendix Z to Part 351—Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Alternative Compliance)

Note: The content of this appendix reproduces the regulation implementing Section 13 of the Bank Holding Company Act as of November 13, 2019.

Subpart A—Authority and Definitions

§ 351.1 Authority, purpose, scope, and relationship to other authorities.

(a) *Authority.* This part is issued by the FDIC under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851).

(b) *Purpose.* Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds by certain banking entities, including any insured depository institution as defined in section 3(c)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(2)) and certain subsidiaries thereof for which the FDIC is the appropriate Federal banking agency as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)). This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and explaining the statute's requirements.

(c) *Scope.* This part implements section 13 of the Bank Holding Company Act with respect to insured depository institutions for which the FDIC is the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act, and certain subsidiaries of the foregoing, but does not include such entities to the extent they are not within the definition of banking entity in § 351.2(c).

(d) Relationship to other authorities. Except as otherwise provided in under section 13 of the Bank Holding Company Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of Bank Holding Company Act shall apply to the activities and investments of a banking entity, even if such activities and investments are authorized for a banking entity under other applicable provisions of law.

(e) *Preservation of authority.* Nothing in this part limits in any way the authority of the FDIC to impose on a banking entity identified in paragraph (c) of this section additional requirements or restrictions with respect to any activity, investment, or relationship covered under section 13 of the Bank Holding Company Act or this part, or additional penalties for violation of this part provided under any other applicable provision of law.

§ 351.2 Definitions.

Unless otherwise specified, for purposes of this part:

[1225] *See* § 351.2(h), (aa). For example, under this part, a security-based swap is both a ''security'' and a ''derivative.'' For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.

[1226] *See* § 351.2(h), (aa).

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) Insured depository institution, unless otherwise indicated, has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(t) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(u) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(v) Qualifying foreign banking organization means a foreign banking organization that qualifies as such under section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(w) *SEC* means the Securities and Exchange Commission.

(x) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(y) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(z) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(aa) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(bb) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(cc) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(dd) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ee) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ff) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

§ 351.3 Prohibition on proprietary trading.

(a) *Prohibition.* Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. *Proprietary trading* means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

(b) *Definition of trading account.* (1) Trading account means any account that is used by a banking entity to:

(i) Purchase or sell one or more financial instruments principally for the purpose of:

(A) Short-term resale;

(B) Benefitting from actual or expected short-term price movements;

(C) Realizing short-term arbitrage profits; or

(D) Hedging one or more positions resulting from the purchases or sales of financial instruments described in paragraphs (b)(1)(i)(A), (B), or (C) of this section;

(ii) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(iii) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale), unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section.

(c) *Financial instrument.* (1) *Financial instrument* means:

(i) A security, including an option on a security;

(ii) A derivative, including an option on a derivative; or

(iii) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(2) A financial instrument does not include:

(i) A loan;

(ii) A commodity that is not:

(A) An excluded commodity (other than foreign exchange or currency);

(B) A derivative;

(C) A contract of sale of a commodity for future delivery; or

(D) An option on a contract of sale of a commodity for future delivery; or

(iii) Foreign exchange or currency.

(d) *Proprietary trading.* Proprietary trading does not include:

(1) Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(2) Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(3) Any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular securities to be used for liquidity management purposes, the amount, types, and risks of these securities that are consistent with liquidity management, and the liquidity circumstances in which the particular securities may or must be used;

(ii) Requires that any purchase or sale of securities contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any securities purchased or sold for liquidity management purposes be highly liquid and limited to securities the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any securities purchased or sold for liquidity management purposes, together with any other instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of securities that are not permitted under §§ 351.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (d)(3) of this section; and

(vi) Is consistent with the FDIC's supervisory requirements, guidance, and expectations regarding liquidity management;

(4) Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments;

(5) Any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(6) Any purchase or sale of one or more financial instruments by a banking entity, so long as:

(i) The purchase (or sale) satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or

(ii) The purchase (or sale) satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding;

(7) Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian;

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity; or

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the FDIC.

(e) *Definition of other terms related to proprietary trading.* For purposes of this subpart:

(1) *Anonymous* means that each party to a purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale.

(2) *Clearing agency* has the same meaning as in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(3) *Commodity* has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(4) *Contract of sale of a commodity for future delivery* means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27))).

(5) Derivatives clearing organization means:

(i) A derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1);

(ii) A derivatives clearing organization that, pursuant to CFTC regulation, is exempt from the registration requirements under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1); or

(iii) A foreign derivatives clearing organization that, pursuant to CFTC regulation, is permitted to clear for a foreign board of trade that is registered with the CFTC.

(6) *Exchange,* unless the context otherwise requires, means any designated contract market, swap execution facility, or foreign board of trade registered with the CFTC, or, for purposes of securities or security-based swaps, an exchange, as defined under section 3(a)(1) of the Exchange Act (15 U.S.C. 78c(a)(1)), or security-based swap execution facility, as defined under section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)).

(7) *Excluded clearing activities* means:

(i) With respect to customer transactions cleared on a derivatives clearing organization, a clearing agency, or a designated financial market utility, any purchase or sale necessary to correct trading errors made by or on behalf of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(ii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a designated financial market utility; and

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

(8) Designated financial market utility has the same meaning as in section 803(4) of the Dodd-Frank Act (12 U.S.C. 5462(4)).

(9) *Issuer* has the same meaning as in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(10) *Market risk capital rule covered position and trading position* means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(11) *Market risk capital rule* means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

(12) *Municipal security* means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

(13) *Trading desk* means 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.

§ 351.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 351.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held;

(C) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(D) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

(iv) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a *distribution* of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this paragraph (a), *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 351.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on:

(A) The liquidity, maturity, and depth of the market for the relevant types of financial instrument(s); and

(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section, on:

(*1*) The amount, types, and risks of its market-maker inventory;

(*2*) The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) The level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) The period of time a financial instrument may be held;

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of this paragraph (b), and independent review of such demonstrable analysis and approval;

(iv) To the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 351.20(d)(1) of subpart D, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(4) *Definition of financial exposure.* For purposes of this paragraph (b), *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker inventory.* For the purposes of this paragraph (b), *market-maker inventory* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

§ 351.5 Permitted risk-mitigating hedging activities.

(a) *Permitted risk-mitigating hedging activities.* The prohibition contained in § 351.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(1) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(i) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(ii) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(iii) The conduct of analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged;

(2) The risk-mitigating hedging activity:

(i) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(ii) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(iii) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(iv) Is subject to continuing review, monitoring and management by the banking entity that:

(A) Is consistent with the written hedging policies and procedures required under paragraph (b)(1) of this section;

(B) Is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(C) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading; and

(3) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(c) *Documentation requirement*—(1) A banking entity must comply with the requirements of paragraphs (c)(2) and (3) of this section with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

(i) Not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce;

(ii) Established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but that is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures established under paragraph (b)(1) of this section or under § 351.4(b)(2)(iii)(B) of this subpart as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or

(iii) Established to hedge aggregated positions across two or more trading desks.

(2) In connection with any purchase or sale identified in paragraph (c)(1) of this section, a banking entity must, at a minimum, and contemporaneously with the purchase or sale, document:

(i) The specific, identifiable risk(s) of the identified positions, contracts, or other holdings of the banking entity that the purchase or sale is designed to reduce;

(ii) The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and

(iii) The trading desk or other business unit that is establishing and responsible for the hedge.

(3) A banking entity must create and retain records sufficient to demonstrate compliance with the requirements of this paragraph (c) for a period that is no less than five years in a form that allows the banking entity to promptly produce such records to the FDIC on request, or such longer period as required under other law or this part.

§ 351.6 Other permitted proprietary trading activities.

(a) *Permitted trading in domestic government obligations.* The prohibition contained in § 351.3(a) does not apply to the purchase or sale by a banking entity of a financial instrument that is:

(1) An obligation of, or issued or guaranteed by, the United States;

(2) An obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*);

(3) An obligation of any State or any political subdivision thereof, including any municipal security; or

(4) An obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(b) *Permitted trading in foreign government obligations*—(1) *Affiliates of foreign banking entities in the United States.* The prohibition contained in § 351.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as:

(i) The banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in paragraph (b)(1)(i) of this section is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The purchase or sale as principal is not made by an insured depository institution.

(2) *Foreign affiliates of a U.S. banking entity.* The prohibition contained in § 351.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as:

(i) The foreign entity is a foreign bank, as defined in section 211.2(j) of the Board's Regulation K (12 CFR 211.2(j)), or is regulated by the foreign sovereign as a securities dealer;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

(c) Permitted trading on behalf of customers—(1) *Fiduciary transactions.* The prohibition contained in § 351.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as trustee or in a similar fiduciary capacity, so long as:

(i) The transaction is conducted for the account of, or on behalf of, a customer; and

(ii) The banking entity does not have or retain beneficial ownership of the financial instruments.

(2) *Riskless principal transactions.* The prohibition contained in § 351.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(d) Permitted trading by a regulated insurance company. The prohibition contained in § 351.3(a) does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if:

(1) The insurance company or its affiliate purchases or sells the financial instruments solely for:

(i) The general account of the insurance company; or

(ii) A separate account established by the insurance company;

(2) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (d)(2) of this section is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

(e) *Permitted trading activities of foreign banking entities.* (1) The prohibition contained in § 351.3(a) does not apply to the purchase or sale of financial instruments by a banking entity if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State;

(ii) The purchase or sale by the banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale meets the requirements of paragraph (e)(3) of this section.

(2) A purchase or sale of financial instruments by a banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (e)(1)(ii) of this section only if:

(i) The purchase or sale is conducted in accordance with the requirements of paragraph (e) of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of any State and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(*1*) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(*2*) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(*3*) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State;

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;

(iv) 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 the laws of the United States or of any State; and

(v) The purchase or sale is not conducted with or through any U.S. entity, other than:

(A) A purchase or sale with the foreign operations of a U.S. entity if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;

(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.

(4) For purposes of this paragraph (e), a U.S. entity is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this paragraph (e), a U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(6) For purposes of this paragraph (e), *unaffiliated market intermediary* means

an unaffiliated entity, acting as an intermediary, that is:

(i) A broker or dealer registered with the SEC under section 15 of the Exchange Act or exempt from registration or excluded from regulation as such;

(ii) A swap dealer registered with the CFTC under section 4s of the Commodity Exchange Act or exempt from registration or excluded from regulation as such;

(iii) A security-based swap dealer registered with the SEC under section 15F of the Exchange Act or exempt from registration or excluded from regulation as such; or

(iv) A futures commission merchant registered with the CFTC under section 4f of the Commodity Exchange Act or exempt from registration or excluded from regulation as such.

§ 351.7 Limitations on permitted proprietary trading activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 351.4 through 351.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§§ 351.8–351.9 [Reserved]

Subpart C—Covered Funds Activities and Investments

§ 351.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) *Prohibition.* (1) Except as otherwise provided in this subpart, a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(2) Paragraph (a)(1) of this section does not include acquiring or retaining an ownership interest in a covered fund by a banking entity:

(i) Acting solely as agent, broker, or custodian, so long as;

(A) The activity is conducted for the account of, or on behalf of, a customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest;

(ii) Through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof) that is established and administered in accordance with the law of the United States or a foreign sovereign, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);

(iii) In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event may the banking entity retain such ownership interest for longer than such period permitted by the FDIC; or

(iv) On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as:

(A) The activity is conducted for the account of, or on behalf of, the customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest.

(b) *Definition of covered fund.* (1) Except as provided in paragraph (c) of this section, covered fund means:

(i) An issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), *but for* section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a–3(c)(1) or (7));

(ii) Any commodity pool under section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10)) for which:

(A) The commodity pool operator has claimed an exemption under 17 CFR 4.7; or

(B)(*1*) A commodity pool operator is registered with the CFTC as a commodity pool operator in connection with the operation of the commodity pool;

(*2*) Substantially all participation units of the commodity pool are owned by qualified eligible persons under 17 CFR 4.7(a)(2) and (3); and

(*3*) Participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons under 17 CFR 4.7(a)(2) and (3); or

(iii) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, an entity that:

(A) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(B) Is, or holds 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; and

(C)(*1*) Has as its sponsor that banking entity (or an affiliate thereof); or

(*2*) Has issued an ownership interest that is owned directly or indirectly by that banking entity (or an affiliate thereof).

(2) An issuer shall not be deemed to be a covered fund under paragraph (b)(1)(iii) of this section if, were the issuer subject to U.S. securities laws, the issuer could rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act.

(3) For purposes of paragraph (b)(1)(iii) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(c) Notwithstanding paragraph (b) of this section, unless the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine otherwise, a covered fund does not include:

(1) *Foreign public funds.* (i) Subject to paragraphs (ii) and (iii) below, an issuer that:

(A) Is organized or established outside of the United States;

(B) Is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and

(C) Sells ownership interests predominantly through one or more public offerings outside of the United States.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and employees of such entities.

(iii) For purposes of paragraph (c)(1)(i)(C) of this section, the term ''public offering'' means a distribution (as defined in § 351.4(a)(3) of subpart B) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(B) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(C) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

(2) *Wholly-owned subsidiaries.* An entity, all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate thereof), except that:

(i) Up to five percent of the entity's outstanding ownership interests, less any amounts outstanding under paragraph (c)(2)(ii) of this section, may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and

(ii) Up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(3) *Joint ventures.* A joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, provided that the joint venture:

(i) Is comprised of no more than 10 unaffiliated co-venturers;

(ii) 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

(iii) 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.

(4) *Acquisition vehicles.* An issuer:

(i) Formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction; and

(ii) That exists only for such period as necessary to effectuate the transaction.

(5) *Foreign pension or retirement funds.* A plan, fund, or program providing pension, retirement, or similar benefits that is:

(i) Organized and administered outside the United States;

(ii) A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and

(iii) Established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.

(6) *Insurance company separate accounts.* A separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses.

(7) *Bank owned life insurance.* A separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is beneficiary, provided that no banking entity that purchases the policy:

(i) Controls the investment decisions regarding the underlying assets or holdings of the separate account; or

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank owned life insurance.

(8) *Loan securitizations.* (i) *Scope.* An issuing entity for asset-backed securities that satisfies all the conditions of this paragraph (c)(8) and the assets or holdings of which are comprised solely of:

(A) Loans as defined in § 351.2(s) of subpart A;

(B) 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 paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(ii) *Impermissible assets.* For purposes of this paragraph (c)(8), the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraph (c)(8)(iii) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities.* Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives.* The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivative directly relate to the loans, the asset-backed securities, or the contractual rights of other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates.* The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in this paragraph (c)(8);

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under this paragraph (c)(8) and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

(9) *Qualifying asset-backed commercial paper conduits.* (i) An issuing entity for asset-backed commercial paper that satisfies all of the following requirements:

(A) The asset-backed commercial paper conduit holds only:

(*1*) Loans and other assets permissible for a loan securitization under paragraph (c)(8)(i) of this section; and

(*2*) Asset-backed securities supported solely by assets that are permissible for loan securitizations under paragraph (c)(8)(i) of this section and acquired by the asset-backed commercial paper conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or directly from an underwriter in the distribution of the asset-backed securities;

(B) The asset-backed commercial paper conduit issues only asset-backed securities, comprised of a residual interest and securities with a legal maturity of 397 days or less; and

(C) A regulated liquidity provider has entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding asset-backed securities issued by the asset-backed commercial paper conduit (other than any residual interest) in the event that funds are required to redeem maturing asset-backed securities.

(ii) For purposes of this paragraph (c)(9), a regulated liquidity provider means:

(A) A depository institution, as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(B) A bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a subsidiary thereof;

(C) A savings and loan holding company, as defined in section 10a of the Home Owners' Loan Act (12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), or a subsidiary thereof;

(D) A foreign bank whose home country supervisor, as defined in § 211.21(q) of the Board's Regulation K (12 CFR 211.21(q)), has adopted capital standards consistent with the Capital Accord for the Basel Committee on banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(E) The United States or a foreign sovereign.

(10) *Qualifying covered bonds*—(i) *Scope.* An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are comprised solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

(ii) *Covered bond.* For purposes of this paragraph (c)(10), a covered bond means:

(A) A debt obligation issued by an entity that meets the definition of foreign banking organization, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section; or

(B) A debt obligation of an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section, provided that the payment obligations are fully and unconditionally guaranteed by an entity that meets the definition of foreign banking organization and the entity is a wholly-owned subsidiary, as defined in paragraph (c)(2) of this section, of such foreign banking organization.

(11) *SBICs and public welfare investment funds.* An issuer:

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked; or

(ii) The business of which is to make investments that are:

(A) Designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(12) *Registered investment companies and excluded entities.* An issuer:

(i) 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 as described in § 351.20(e)(3) of subpart D and that complies with the requirements of section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a–18);

(ii) That may rely on an exclusion or exemption from the definition of "investment company" under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act; or

(iii) That has elected to be regulated as a business development company 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 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 (15 U.S.C. 80a–60).

(13) *Issuers in conjunction with the FDIC's receivership or conservatorship operations.* An issuer that is an entity formed by or on behalf of the FDIC for the purpose of facilitating the disposal of assets acquired in the FDIC's capacity as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(14) *Other excluded issuers.* (i) Any issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act.

(ii) A determination made under paragraph (c)(14)(i) of this section will be promptly made public.

(d) *Definition of other terms related to covered funds.* For purposes of this subpart:

(1) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the FDIC determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(2) *Asset-backed security* has the meaning specified in Section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)).

(3) *Director* has the same meaning as provided in section 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

(4) *Issuer* has the same meaning as in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(22)).

(5) *Issuing entity* means with respect to asset-backed securities the special purpose vehicle that owns or holds the pool assets underlying asset-backed securities and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

(6) *Ownership interest*—(i) *Ownership interest* means any equity, partnership, or other similar interest. An "other similar interest" means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs (d)(6)(i)(A) through (F) of this section.

(ii) *Ownership interest* does not include: *Restricted profit interest.* An interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(A) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(B) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(C) Any amounts invested in the covered fund, including any amounts paid by the entity (or employee or former employee thereof) in connection with obtaining the restricted profit interest, are within the limits of § 351.12 of this subpart; and

(D) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

(7) *Prime brokerage transaction* means 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.

(8) Resident of the United States means a person that is a "U.S. person" as defined in rule 902(k) of the SEC's Regulation S (17 CFR 230.902(k)).

(9) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name, except as permitted under § 351.11(a)(6).

(10) *Trustee.* (i) For purposes of paragraph (d)(9) of this section and § 351.11 of subpart C, a trustee does not include:

(A) A trustee that does not exercise investment discretion with respect to a covered fund, including a trustee that is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)); or

(B) A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to those described in paragraph (d)(10)(i)(A) of this section;

(ii) Any entity that directs a person described in paragraph (d)(10)(i) of this section, or that possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee, shall be considered to be a trustee of such covered fund.

§ 351.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

(a) *Organizing and offering a covered fund in general.* Notwithstanding § 351.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund in connection with, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, only if:

(1) The banking entity (or an affiliate thereof) provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services;

(2) The covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity (or an affiliate thereof), pursuant to a written plan or similar documentation outlining how the banking entity or such affiliate intends to provide advisory or similar services to its customers through organizing and offering such fund;

(3) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under § 351.12 of this subpart;

(4) The banking entity and its affiliates comply with the requirements of § 351.14 of this subpart;

(5) The banking entity and its affiliates do 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;

(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof), except that a covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

(A) The investment adviser is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(B) The investment adviser does not share the same name or a variation of the same name as an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(ii) Does not use the word ''bank'' in its name;

(7) No director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity or such affiliate who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

(8) The banking entity:

(i) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(A) That ''any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity] or its affiliates; therefore, [the banking entity's] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity] and any affiliate in its capacity as investor in the [covered fund] or as beneficiary of a restricted profit interest held by [the banking entity] or any affiliate'';

(B) That such investor should read the fund offering documents before investing in the covered fund;

(C) That the ''ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity'' (unless that happens to be the case); and

(D) The role of the banking entity and its affiliates and employees in sponsoring or providing any services to the covered fund; and

(ii) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates.

(b) *Organizing and offering an issuing entity of asset-backed securities.* (1) Notwithstanding § 351.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuing entity of asset-backed securities in connection with, directly or indirectly, organizing and offering that issuing entity, so long as the banking entity and its affiliates comply with all of the requirements of paragraph (a)(3) through (8) of this section.

(2) For purposes of this paragraph (b), organizing and offering a covered fund that is an issuing entity of asset-backed securities means acting as the securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)) of the issuing entity, or acquiring or retaining an ownership interest in the issuing entity as required by section 15G of that Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder.

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 351.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 351.4(a) or § 351.4(b) of subpart B, respectively;

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section; or, directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 351.12(a)(2)(ii) and § 351.12(d) of this subpart; and

(3) With respect to any banking entity, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under § 351.11 of this subpart, including all covered funds in which the banking entity holds an ownership interest in connection with underwriting and market making related activities permitted under this paragraph (c), are included in the calculation of all ownership interests under § 351.12(a)(2)(iii) and § 351.12(d) of this subpart.

§ 351.12 Permitted investment in a covered fund.

(a) Authority and limitations on permitted investments in covered funds. (1) Notwithstanding the prohibition contained in § 351.10(a) of this subpart, a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity or an affiliate thereof organizes and offers pursuant to § 351.11, for the purposes of:

(i) *Establishment.* Establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, subject to the limits contained in paragraphs (a)(2)(i) and (iii) of this section; or

(ii) *De minimis investment.* Making and retaining an investment in the covered fund subject to the limits contained in paragraphs (a)(2)(ii) and (iii) of this section.

(2) *Investment limits*—(i) *Seeding period.* With respect to an investment in any covered fund made or held pursuant to paragraph (a)(1)(i) of this section, the banking entity and its affiliates:

(A) Must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) Must, no later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section), conform its ownership interest in the covered fund to the limits in paragraph (a)(2)(ii) of this section;

(ii) *Per-fund limits.* (A) Except as provided in paragraph (a)(2)(ii)(B) of this section, an investment by a banking entity and its affiliates in any covered fund made or held pursuant to paragraph (a)(1)(ii) of this section may not exceed 3 percent of the total number or value of the outstanding ownership interests of the fund.

(B) An investment by a banking entity and its affiliates in a covered fund that is an issuing entity of asset-backed securities may not exceed 3 percent of the total fair market value of the ownership interests of the fund measured in accordance with paragraph (b)(3) of this section, unless a greater percentage is retained by the banking entity and its affiliates in compliance with the requirements of section 15G of the Exchange Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the amount, number, or value of ownership interests of the fund required under section 15G of the Exchange Act and the implementing regulations issued thereunder.

(iii) *Aggregate limit.* The aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired or retained under this section may not exceed 3 percent of the tier 1 capital of the banking entity, as provided under paragraph (c) of this section, and shall be calculated as of the last day of each calendar quarter.

(iv) *Date of establishment.* For purposes of this section, the date of establishment of a covered fund shall be:

(A) *In general.* The date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund;

(B) *Issuing entities of asset-backed securities.* In the case of an issuing entity of asset-backed securities, the date on which the assets are initially transferred into the issuing entity of asset-backed securities.

(b) *Rules of construction*—(1) *Attribution of ownership interests to a covered banking entity.* (i) For purposes of paragraph (a)(2) of this section, the amount and value of a banking entity's permitted investment in any single covered fund shall include any ownership interest held under § 351.12 directly by the banking entity, including any affiliate of the banking entity.

(ii) Treatment of registered investment companies, SEC-regulated business development companies and foreign public funds. For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies or foreign public fund as described in § 351.10(c)(1) of this subpart will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

(iii) *Covered funds.* For purposes of paragraph (b)(1)(i) of this section, a covered fund will not be considered to be an affiliate of a banking entity so long as the covered fund is held in compliance with the requirements of this subpart.

(iv) Treatment of employee and director investments financed by the banking entity. For purposes of paragraph (b)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires an ownership interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to

acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(2) *Calculation of permitted ownership interests in a single covered fund.* Except as provided in paragraph (b)(3) or (4), for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(A) of this section:

(i) The aggregate number of the outstanding ownership interests held by the banking entity shall be the total number of ownership interests held under this section by the banking entity in a covered fund divided by the total number of ownership interests held by all entities in that covered fund, as of the last day of each calendar quarter (both measured without regard to committed funds not yet called for investment);

(ii) The aggregate value of the outstanding ownership interests held by the banking entity shall be the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity, divided by the value of all investments in and capital contributions made to that covered fund by all entities, as of the last day of each calendar quarter (all measured without regard to committed funds not yet called for investment). If fair market value cannot be determined, then the value shall be the historical cost basis of all investments in and contributions made by the banking entity to the covered fund;

(iii) For purposes of the calculation under paragraph (b)(2)(ii) of this section, once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards.

(3) Issuing entities of asset-backed securities. In the case of an ownership interest in an issuing entity of asset-backed securities, for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(B) of this section:

(i) For securitizations subject to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11), the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder; or

(ii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the calculations shall be made as of the date of establishment as defined in paragraph (a)(2)(iv)(B) of this section or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund, and thereafter only upon the date on which additional securities of the issuing entity of asset-backed securities are priced for purposes of the sales of ownership interests to unaffiliated investors.

(iii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

(iv) For purposes of the calculation under paragraph (b)(3)(iii) of this section, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards.

(4) *Multi-tier fund investments*—(i) *Master-feeder fund investments.* If the principal investment strategy of a covered fund (the ''feeder fund'') is to invest substantially all of its assets in another single covered fund (the ''master fund''), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest of the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments.* If a banking entity organizes and offers a covered fund pursuant to § 351.11 of this subpart for the purpose of investing in other covered funds (a ''fund of funds'') and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest of the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(c) *Aggregate permitted investments in all covered funds.* (1) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 351.10(d)(6)(ii) of this subpart), on a historical cost basis.

(2) *Calculation of tier 1 capital.* For purposes of paragraph (a)(2)(iii) of this section:

(i) *Entities that are required to hold and report tier 1 capital.* If a banking entity is required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be equal to the amount of tier 1 capital of the banking entity as of the last day of the most recent calendar quarter, as reported to its primary financial regulatory agency; and

(ii) If a banking entity is not required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, be equal to the amount of tier 1 capital reported by such controlling depository institution in the manner described in paragraph (c)(2)(i) of this section;

(B) In the case of a banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(*1*) *Bank holding company subsidiaries.* If the banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, be equal to the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital in the manner described in paragraph (c)(2)(i) of this section; and

(2) Other holding companies and any subsidiary or affiliate thereof. If the banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, be equal to the total amount

of shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(iii) *Treatment of foreign banking entities*—(A) *Foreign banking entities.* Except as provided in paragraph (c)(2)(iii)(B) of this section, with respect to a banking entity that is not itself, and is not controlled directly or indirectly by, a banking entity that is located or organized under the laws of the United States or of any State, the tier 1 capital of the banking entity shall be the consolidated tier 1 capital of the entity as calculated under applicable home country standards.

(B) *U.S. affiliates of foreign banking entities.* With respect to a banking entity that is located or organized under the laws of the United States or of any State and is controlled by a foreign banking entity identified under paragraph (c)(2)(iii)(A) of this section, the banking entity's tier 1 capital shall be as calculated under paragraphs (c)(2)(i) or (ii) of this section.

(d) *Capital treatment for a permitted investment in a covered fund.* For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 351.10(d)(6)(ii) of subpart C), on a historical cost basis, plus any earnings received; and

(2) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (b)(3) of this section (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 351.10(d)(6)(ii) of subpart C), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(e) *Extension of time to divest an ownership interest.* (1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(2) *Factors governing Board determinations.* In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;

(v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;

(vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;

(vi) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;

(viii) Market conditions; and

(ix) Any other factor that the Board believes appropriate.

(3) *Authority to impose restrictions on activities or investment during any extension period.* The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(4) *Consultation.* In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

§ 351.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 351.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund.

(2) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks arising in connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) The compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to this paragraph and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) *Certain permitted covered fund activities and investments outside of the United States.* (1) The prohibition contained in § 351.10(a) of this subpart does not apply to the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a banking entity only if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in the covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity or investment occurs solely outside of the United States.

(2) An activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (b)(1)(ii) of this section only if:

(i) The activity or investment is conducted in accordance with the requirements of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of one or more States and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is sold or has been sold pursuant to an offering that does not target residents of the United States.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State;

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and

(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this section, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States; however, a foreign bank of which that branch, agency, or subsidiary is a part is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 351.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

§ 351.14 Limitations on relationships with a covered fund.

(a) Relationships with a covered fund. (1) Except as provided for in paragraph (a)(2) of this section, no 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 this subpart, or that continues to hold an ownership interest in accordance with § 351.11(b) of this subpart, and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of § 351.11, § 351.12, or § 351.13 of this subpart; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate thereof) has taken an ownership interest, if:

(A) The banking entity is in compliance with each of the limitations set forth in § 351.11 of this subpart with respect to a covered fund organized and offered by such banking entity (or an affiliate thereof);

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually to the FDIC (with a duty to update the certification if the information in the certification materially changes) 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; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

(b) *Restrictions on transactions with covered funds.* A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § 351.11 of this subpart, or that continues to hold an ownership interest in accordance with § 351.11(b) of this subpart, shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1), as if such banking entity were a member bank and such covered fund were an affiliate thereof.

(c) *Restrictions on prime brokerage transactions.* A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1) as if the counterparty were an affiliate of the banking entity.

§ 351.15 Other limitations on permitted covered fund activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 351.11 through 351.13 of this subpart if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§ 351.16 Ownership of Interests in and Sponsorship of Issuers of Certain Collateralized Debt Obligations Backed by Trust-Preferred Securities.

(a) The prohibition contained in § 351.10(a)(1) does not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer if:

(1) The issuer was established, and the interest was issued, before May 19, 2010;

(2) The banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral; and

(3) The banking entity acquired such interest on or before December 10, 2013 (or acquired such interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before December 10, 2013).

(b) For purposes of this § 351.16, *Qualifying TruPS Collateral* shall mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument, had total consolidated assets of less than $15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company.

(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 §§ 351.4 and 351.11.

(d) Without limiting the applicability of paragraph (a) of this section, the Board, the FDIC and the OCC will make public a non-exclusive list of issuers that meet the requirements of paragraph (a). A banking entity may rely on the list published by the Board, the FDIC and the OCC.

§§ 351.17–351.19 [Reserved]

Subpart D—Compliance Program Requirement; Violations

§ 351.20 Program for compliance; reporting.

(a) *Program requirement.* 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 this part. The terms, scope and detail of the compliance program shall be appropriate for the types, size, scope and complexity of activities and business structure of the banking entity.

(b) Contents of compliance program. Except as provided in paragraph (f) of this section, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities subject to subpart B (including those permitted under §§ 351.3 to 351.6 of subpart B), including setting, monitoring and managing required limits set out in § 351.4 and § 351.5, and activities and investments with respect to a covered fund subject to subpart C (including those permitted under §§ 351.11 through 351.14 of subpart C) conducted by the banking entity to ensure that all activities and investments conducted by the banking entity that are subject to section 13 of the BHC Act and this part comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and this part and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in this part or by management as requiring attention;

(4) Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a banking entity must promptly provide to the FDIC upon request and retain for a period of no less than 5 years or such longer period as required by the FDIC.

(c) *Additional standards.* In addition to the requirements in paragraph (b) of this section, the compliance program of a banking entity must satisfy the requirements and other standards contained in Appendix B, if:

(1) The banking entity engages in proprietary trading permitted under subpart B and is required to comply with the reporting requirements of paragraph (d) of this section;

(2) The banking entity has reported total consolidated assets as of the previous calendar year end of $50 billion or more or, in the case of a foreign banking entity, has total U.S. assets as of the previous calendar year end of $50 billion or more (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States); or

(3) The FDIC notifies the banking entity in writing that it must satisfy the requirements and other standards contained in Appendix B to this part.

(d) *Reporting requirements under Appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in Appendix A, if:

(i) The banking entity (other than a foreign banking entity as provided in paragraph (d)(1)(ii) of this section) has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section;

(ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section; or

(iii) The FDIC notifies the banking entity in writing that it must satisfy the reporting requirements contained in Appendix A.

(2) The threshold for reporting under paragraph (d)(1) of this section shall be $50 billion beginning on June 30, 2014; $25 billion beginning on April 30, 2016; and $10 billion beginning on December 31, 2016.

(3) Frequency of reporting: Unless the FDIC notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with paragraph (d)(1) of this section) shall report the information required by Appendix A for each calendar month within 30 days of the end of the relevant calendar month; beginning with information for the month of January 2015, such information shall be reported within 10 days of the end of each calendar month. Any other banking entity subject to Appendix A shall report the information required by Appendix A for each calendar quarter within 30 days of the end of that calendar quarter unless the FDIC notifies the banking entity in writing that it must report on a different basis.

(e) Additional documentation for covered funds. Any banking entity that has more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years shall maintain records that include:

(1) Documentation of the exclusions or exemptions other than sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund;

(2) For each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of covered fund provided by §§ 351.10(c)(1), 351.10(c)(5), 351.10(c)(8), 351.10(c)(9), or 351.10(c)(10) of subpart C, documentation supporting the banking entity's determination that the fund is not a covered fund pursuant to one or more of those exclusions;

(3) For each seeding vehicle described in § 351.10(c)(12)(i) or (iii) of subpart C that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § 351.12(a)(2)(i)(B) of subpart C;

(4) For any banking entity that is, or is controlled directly or indirectly by a

banking entity that is, located in or organized under the laws of the United States or of any State, if the aggregate amount of ownership interests in foreign public funds that are described in § 351.10(c)(1) of subpart C owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or of any State) exceeds $50 million at the end of two or more consecutive calendar quarters, beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar quarter, which documentation must continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters; and

(5) For purposes of paragraph (e)(4) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(f) *Simplified programs for less active banking entities*—(1) *Banking entities with no covered activities.* A banking entity that does not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § 351.6(a) of subpart B) may satisfy the requirements of this section by establishing the required compliance program prior to becoming engaged in such activities or making such investments (other than trading activities permitted pursuant to § 351.6(a) of subpart B).

(2) *Banking entities with modest activities.* A banking entity with total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engages in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted under § 351.6(a) of subpart B) may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope and complexity of the banking entity.

§ 351.21 Termination of activities or investments; penalties for violations.

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the FDIC finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or this part, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or this part, the FDIC may take any action permitted by law to enforce compliance with section 13 of the BHC Act and this part, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

Appendix A to Part 351—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 351.20(d), this appendix generally applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the FDIC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 351.20 and Appendix B.

b. The purpose of this appendix is to assist banking entities and the FDIC in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 351.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 351.4, 351.5, or 351.6(a)–(b) (*i.e.,* underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the FDIC of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. The quantitative measurements that must be furnished pursuant to this appendix are *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In order to allow banking entities and the Agencies to evaluate the effectiveness of these metrics, banking entities must collect and report these metrics for all trading desks beginning on the dates established in § 351.20 of the final rule. The Agencies will review the data collected and revise this collection requirement as appropriate based on a review of the data collected prior to September 30, 2015.

e. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 351.20 and Appendix B to this part. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

f. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 351.4 through 351.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the FDIC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 351.2 and 351.3. In addition, for purposes of this appendix, the following definitions apply:

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 351.4, 351.5, 351.6(a), or 351.6(b). A banking entity may include trading under §§ 351.3(d), 351.6(c), 351.6(d) or 351.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading desk means 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.

III. Reporting and Recordkeeping of Quantitative Measurements

a. Scope of Required Reporting

General scope. Each banking entity made subject to this part by § 351.20 must furnish the following quantitative measurements for each trading desk of the banking entity, calculated in accordance with this appendix:

- Risk and Position Limits and Usage;
- Risk Factor Sensitivities;
- Value-at-Risk and Stress VaR;
- Comprehensive Profit and Loss Attribution;
- Inventory Turnover;
- Inventory Aging; and
- Customer-Facing Trade Ratio

b. Frequency of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report each applicable quantitative measurement to the FDIC on the reporting schedule established in § 351.20 unless otherwise requested by the FDIC. All quantitative measurements for any calendar month must be reported within the time period required by § 351.20.

c. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the FDIC pursuant to this appendix and § 351.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the FDIC to verify the accuracy of such reports, for a period of 5 years from the end of the calendar year for which the measurement was taken.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the portion of the trading desk's limits that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited, to the limits set out in § 351.4 and § 351.5. A number of the metrics that are described below, including ''Risk Factor Sensitivities'' and ''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 activities under § 351.4(b) and hedging activity under § 351.5. Accordingly, the limits required under § 351.4(b)(2)(iii) and § 351.5(b)(1)(i) must meet the applicable requirements under § 351.4(b)(2)(iii) and § 351.5(b)(1)(i) and also must include appropriate metrics for the trading desk limits including, at a minimum, the ''Risk Factor Sensitivities'' and ''Value-at-Risk and Stress Value-at-Risk'' metrics except to the extent any of the ''Risk Factor Sensitivities'' or ''Value-at-Risk and Stress Value-at-Risk'' metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

ii. *General Calculation Guidance:* Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached must be reported.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

2. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk.

ii. *General Calculation Guidance:* A banking entity must report the Risk Factor Sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. The underlying data and methods used to compute a trading desk's Risk Factor Sensitivities will depend on the specific function of the trading desk and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading desk, and furnished to the FDIC, will depend on the explicit risks assumed by the trading desk. In general, however, reported Risk Factor Sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings.

A. Trading desks must take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:

- *Commodity derivative positions:* Risk factors with respect to the related commodities set out in 17 CFR 20.2, the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Credit positions:* Risk factors with respect to credit spreads that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and risk factors with respect to interest rates of all relevant maturities;
- *Credit-related derivative positions:* Risk factor sensitivities, for example credit spreads, shifts (parallel and non-parallel) in credit spreads—volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity derivative positions:* Risk factor sensitivities such as equity positions, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity positions:* Risk factors for equity prices and risk factors that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;
- *Foreign exchange derivative positions:* Risk factors with respect to major currency pairs and maturities, exposure to interest rates at relevant maturities, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and
- *Interest rate positions, including interest rate derivative positions:* Risk factors with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and shifts (parallel and non-parallel) in the interest rate curve, as well as the maturity profile of the positions.

B. The methods used by a banking entity to calculate sensitivities to a common factor shared by multiple trading desks, such as an equity price factor, must be applied consistently across its trading desks so that the sensitivities can be compared from one trading desk to another.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Value-at-Risk and Stress Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the commonly used percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on current market conditions. For purposes of this appendix, Stress Value-at-Risk (''Stress VaR'') is the percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on market conditions during a period of significant financial stress.

ii. *General Calculation Guidance:* Banking entities must compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading desk that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR must be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions''); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (*i.e.,* the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific Risk Factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

C. The portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *General Calculation Guidance:* The specific categories used by a trading desk in the attribution analysis and amount of detail for the analysis should be tailored to the type and amount of trading activities undertaken by the trading desk. The new position attribution must be computed by calculating the difference between the prices at which instruments were bought and/or sold and the prices at which those instruments are marked to market at the close of business on that day multiplied by the notional or principal amount of each purchase or sale. Any fees, commissions, or other payments received (paid) that are associated with transactions executed on that day must be added (subtracted) from such difference. These factors must be measured consistently over time to facilitate historical comparisons.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

c. Customer-Facing Activity Measurements

1. Inventory Turnover

i. *Description:* For purposes of this appendix, Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period.

ii. *General Calculation Guidance:* For purposes of this appendix, for derivatives, other than options and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

2. Inventory Aging

i. *Description:* For purposes of this appendix, Inventory Aginggenerally describes a schedule of the trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held. Inventory Aging should measure the age profile of the trading desk's assets and liabilities.

ii. *General Calculation Guidance:* In general, Inventory Aging must be computed using a trading desk's trading activity data and must identify the value of a trading desk's aggregate assets and liabilities. Inventory Aging must include two schedules, an asset-aging schedule and a liability-aging schedule. Each schedule must record the value of assets or liabilities held over all holding periods. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value and, for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Customer-Facing Trade Ratio—Trade Count Based and Value Based

i. *Description:* For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A trade count based ratio must be computed that records the number of transactions involving a counterparty that is a customer of the trading desk and the number of transactions involving a counterparty that is not a customer of the trading desk. A value based ratio must be computed that records the value of transactions involving a counterparty that is a customer of the trading desk and the value of transactions involving a counterparty that is not a customer of the trading desk.

ii. *General Calculation Guidance:* For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 351.20(d)(1) unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

Appendix B to Part 351—Enhanced Minimum Standards for Compliance Programs

I. Overview

Section 351.20(c) requires certain banking entities to establish, maintain, and enforce an enhanced compliance program that includes the requirements and standards in this Appendix as well as the minimum written policies and procedures, internal controls, management framework, independent testing, training, and recordkeeping provisions outlined in § 351.20. This Appendix sets forth additional minimum standards with respect to the establishment, oversight, maintenance, and enforcement by these banking entities of an enhanced internal compliance program for ensuring and monitoring 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 this part.

a. This compliance program must:

1. Be reasonably designed to identify, document, monitor, and report the permitted trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these covered activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and this part;

2. Establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and this part;

3. Subject the effectiveness of the compliance program to periodic independent review and testing, and ensure that the entity's internal audit, corporate compliance and internal control functions involved in review and testing are effective and independent;

4. Make senior management, and others as appropriate, accountable for the effective implementation of the compliance program, and ensure that the board of directors and chief executive officer (or equivalent) of the banking entity review the effectiveness of the compliance program; and

5. Facilitate supervision and examination by the Agencies of the banking entity's permitted trading and covered fund activities and investments.

II. Enhanced Compliance Program

a. *Proprietary Trading Activities.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, and complexity of, and risks associated with, its permitted trading activities. The compliance program may be tailored to the types of trading activities conducted by the banking entity, and must include a detailed description of controls established by the banking entity to reasonably ensure that its trading activities are conducted in accordance with the requirements and limitations applicable to those trading activities under section 13 of the BHC Act and this part, and provide for appropriate revision of the compliance program before expansion of the trading activities of the banking entity. A banking entity must devote adequate resources and use knowledgeable personnel in conducting, supervising and managing its trading activities, and promote consistency, independence and rigor in implementing its risk controls and compliance efforts. The compliance program must be updated with a frequency sufficient to account for changes in the activities of the banking entity, results of independent testing of the program, identification of weaknesses in the program, and changes in legal, regulatory or other requirements.

1. *Trading Desks:* The banking entity must have written policies and procedures governing each trading desk that include a description of:

i. The process for identifying, authorizing and documenting financial instruments each trading desk may purchase or sell, with separate documentation for market making-related activities conducted in reliance on § 351.4(b) and for hedging activity conducted in reliance on § 351.5;

ii. A mapping for each trading desk to the division, business line, or other organizational structure that is responsible for managing and overseeing the trading desk's activities;

iii. The mission (*i.e.,* the type of trading activity, such as market-making, trading in sovereign debt, etc.) and strategy (*i.e.,* methods for conducting authorized trading activities) of each trading desk;

iv. The activities that the trading desk is authorized to conduct, including (i) authorized instruments and products, and (ii) authorized hedging strategies, techniques and instruments;

v. The types and amount of risks allocated by the banking entity to each trading desk to implement the mission and strategy of the trading desk, including an enumeration of material risks resulting from the activities in which the trading desk is authorized to engage (including but not limited to price risks, such as basis, volatility and correlation risks, as well as counterparty credit risk). Risk assessments must take into account both the risks inherent in the trading activity and the strength and effectiveness of controls designed to mitigate those risks;

vi. How the risks allocated to each trading desk will be measured;

vii. Why the allocated risks levels are appropriate to the activities authorized for the trading desk;

viii. The limits on the holding period of, and the risk associated with, financial instruments under the responsibility of the trading desk;

ix. The process for setting new or revised limits, as well as escalation procedures for granting exceptions to any limits or to any policies or procedures governing the desk, the analysis that will be required to support revising limits or granting exceptions, and the process for independently reviewing and documenting those exceptions and the underlying analysis;

x. The process for identifying, documenting and approving new products, trading strategies, and hedging strategies;

xi. The types of clients, customers, and counterparties with whom the trading desk may trade; and

xii. The compensation arrangements, including incentive arrangements, for employees associated with the trading desk, which may not be designed to reward or incentivize prohibited proprietary trading or excessive or imprudent risk-taking.

2. *Description of risks and risk management processes:* The compliance program for the banking entity must include a comprehensive description of the risk management program for the trading activity of the banking entity. The compliance program must also include a description of the governance, approval, reporting, escalation, review and other processes the banking entity will use to reasonably ensure that trading activity is conducted in compliance with section 13 of the BHC Act and this part. Trading activity in similar financial instruments should be subject to similar governance, limits, testing, controls, and review, unless the banking entity specifically determines to establish different limits or processes and documents those differences. Descriptions must include, at a minimum, the following elements:

i. A description of the supervisory and risk management structure governing all trading activity, including a description of processes for initial and senior-level review of new products and new strategies;

ii. A description of the process for developing, documenting, testing, approving and reviewing all models used for valuing, identifying and monitoring the risks of trading activity and related positions, including the process for periodic independent testing of the reliability and accuracy of those models;

iii. A description of the process for developing, documenting, testing, approving and reviewing the limits established for each trading desk;

iv. A description of the process by which a security may be purchased or sold pursuant to the liquidity management plan, including the process for authorizing and monitoring such activity to ensure compliance with the banking entity's liquidity management plan and the restrictions on liquidity management activities in this part;

v. A description of the management review process, including escalation procedures, for approving any temporary exceptions or permanent adjustments to limits on the activities, positions, strategies, or risks associated with each trading desk; and

vi. The role of the audit, compliance, risk management and other relevant units for conducting independent testing of trading and hedging activities, techniques and strategies.

3. *Authorized risks, instruments, and products.* The banking entity must implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that trading activity is conducted in conformance with

section 13 of the BHC Act and this part and with the banking entity's written policies and procedures. The banking entity must establish and enforce risk limits appropriate for the activity of each trading desk. These limits should be based on probabilistic and non-probabilistic measures of potential loss (*e.g.,* Value-at-Risk and notional exposure, respectively), and measured under normal and stress market conditions. At a minimum, these internal controls must monitor, establish and enforce limits on:

i. The financial instruments (including, at a minimum, by type and exposure) that the trading desk may trade;

ii. The types and levels of risks that may be taken by each trading desk; and

iii. The types of hedging instruments used, hedging strategies employed, and the amount of risk effectively hedged.

4. *Hedging policies and procedures.* The banking entity must establish, maintain, and enforce written policies and procedures regarding the use of risk-mitigating hedging instruments and strategies that, at a minimum, describe:

i. The positions, techniques and strategies that each trading desk may use to hedge the risk of its positions;

ii. The manner in which the banking entity will identify the risks arising in connection with and related to the individual or aggregated positions, contracts or other holdings of the banking entity that are to be hedged and determine that those risks have been properly and effectively hedged;

iii. The level of the organization at which hedging activity and management will occur;

iv. The manner in which hedging strategies will be monitored and the personnel responsible for such monitoring;

v. The risk management processes used to control unhedged or residual risks; and

vi. The process for developing, documenting, testing, approving and reviewing all hedging positions, techniques and strategies permitted for each trading desk and for the banking entity in reliance on § 351.5.

5. *Analysis and quantitative measurements.* The banking entity must perform robust analysis and quantitative measurement of its trading activities that is reasonably designed to ensure that the trading activity of each trading desk is consistent with the banking entity's compliance program; monitor and assist in the identification of potential and actual prohibited proprietary trading activity; and prevent the occurrence of prohibited proprietary trading. Analysis and models used to determine, measure and limit risk must be rigorously tested and be reviewed by management responsible for trading activity to ensure that trading activities, limits, strategies, and hedging activities do not understate the risk and exposure to the banking entity or allow prohibited proprietary trading. This review should include periodic and independent back-testing and revision of activities, limits, strategies and hedging as appropriate to contain risk and ensure compliance. In addition to the quantitative measurements reported by any banking entity subject to Appendix A to this part, each banking entity must develop and implement, to the extent appropriate to facilitate compliance with this part, additional quantitative measurements specifically tailored to the particular risks, practices, and strategies of its trading desks. The banking entity's analysis and quantitative measurements must incorporate the quantitative measurements reported by the banking entity pursuant to Appendix A (if applicable) and include, at a minimum, the following:

i. Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of quantitative measurements;

ii. Ongoing, timely monitoring and review of calculated quantitative measurements;

iii. The establishment of numerical thresholds and appropriate trading measures for each trading desk and heightened review of trading activity not consistent with those thresholds to ensure compliance with section 13 of the BHC Act and this part, including analysis of the measurement results or other information, appropriate escalation procedures, and documentation related to the review; and

iv. Immediate review and compliance investigation of the trading desk's activities, escalation to senior management with oversight responsibilities for the applicable trading desk, timely notification to the FDIC, appropriate remedial action (*e.g.,* divesting of impermissible positions, cessation of impermissible activity, disciplinary actions), and documentation of the investigation findings and remedial action taken when quantitative measurements or other information, considered together with the facts and circumstances, or findings of internal audit, independent testing or other review suggest a reasonable likelihood that the trading desk has violated any part of section 13 of the BHC Act or this part.

6. *Other Compliance Matters.* In addition to the requirements specified above, the banking entity's compliance program must:

i. Identify activities of each trading desk that will be conducted in reliance on exemptions contained in §§ 351.4 through 351.6, including an explanation of:

A. How and where in the organization the activity occurs; and

B. Which exemption is being relied on and how the activity meets the specific requirements for reliance on the applicable exemption;

ii. Include an explanation of the process for documenting, approving and reviewing actions taken pursuant to the liquidity management plan, where in the organization this activity occurs, the securities permissible for liquidity management, the process for ensuring that liquidity management activities are not conducted for the purpose of prohibited proprietary trading, and the process for ensuring that securities purchased as part of the liquidity management plan are highly liquid and conform to the requirements of this part;

iii. Describe how the banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each trading desk that relies on the exemptions contained in §§ 351.3(d)(3), and 351.4 through 351.6, which must take into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in value cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that result in large and significant concentrations to sectors, risk factors, or counterparties;

iv. Establish responsibility for compliance with the reporting and recordkeeping requirements of subpart B and § 351.20; and

v. Establish policies for monitoring and prohibiting potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties.

7. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any trading activity that may indicate potential violations of section 13 of the BHC Act and this part and to prevent actual violations of section 13 of the BHC Act and this part. The compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

b. *Covered Fund Activities or Investments.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, complexity and risks of the covered fund and related activities conducted and investments made, by the banking entity.

1. *Identification of covered funds.* The banking entity's compliance program must provide a process, which must include appropriate management review and independent testing, for identifying and documenting covered funds that each unit within the banking entity's organization

sponsors or organizes and offers, and covered funds in which each such unit invests. In addition to the documentation requirements for covered funds, as specified under § 351.20(e), the documentation must include information that identifies all pools that the banking entity sponsors or has an interest in and the type of exemption from the Commodity Exchange Act (whether or not the pool relies on section 4.7 of the regulations under the Commodity Exchange Act), and the amount of ownership interest the banking entity has in those pools.

2. *Identification of covered fund activities and investments.* The banking entity's compliance program must identify, document and map each unit within the organization that is permitted to acquire or hold an interest in any covered fund or sponsor any covered fund and map each unit to the division, business line, or other organizational structure that will be responsible for managing and overseeing that unit's activities and investments.

3. *Explanation of compliance.* The banking entity's compliance program must explain how:

i. The banking entity monitors for and prohibits potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties related to its covered fund activities and investments;

ii. The banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the banking entity related to its covered fund activities and investments; and

iii. The banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by its covered fund activities and investments, taking into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in values cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that expose the banking entity to large and significant concentrations with respect to sectors, risk factors, or counterparties;

4. *Description and documentation of covered fund activities and investments.* For each organizational unit engaged in covered fund activities and investments, the banking entity's compliance program must document:

i. The covered fund activities and investments that the unit is authorized to conduct;

ii. The banking entity's plan for actively seeking unaffiliated investors to ensure that any investment by the banking entity conforms to the limits contained in § 351.12 or registered in compliance with the securities laws and thereby exempt from those limits within the time periods allotted in § 351.12; and

iii. How it complies with the requirements of subpart C.

5. *Internal Controls.* A banking entity must establish, maintain, and enforce internal controls that are reasonably designed to ensure that its covered fund activities or investments comply with the requirements of section 13 of the BHC Act and this part and are appropriate given the limits on risk established by the banking entity. These written internal controls must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part. The internal controls must, at a minimum require:

i. Monitoring and limiting the banking entity's individual and aggregate investments in covered funds;

ii. Monitoring the amount and timing of seed capital investments for compliance with the limitations under subpart C (including but not limited to the redemption, sale or disposition requirements) of § 351.12, and the effectiveness of efforts to seek unaffiliated investors to ensure compliance with those limits;

iii. Calculating the individual and aggregate levels of ownership interests in one or more covered fund required by § 351.12;

iv. Attributing the appropriate instruments to the individual and aggregate ownership interest calculations above;

v. Making disclosures to prospective and actual investors in any covered fund organized and offered or sponsored by the banking entity, as provided under § 351.11(a)(8);

vi. Monitoring for and preventing any relationship or transaction between the banking entity and a covered fund that is prohibited under § 351.14, including where the banking entity has been designated as the sponsor, investment manager, investment adviser, or commodity trading advisor to a covered fund by another banking entity; and

vii. Appropriate management review and supervision across legal entities of the banking entity to ensure that services and products provided by all affiliated entities comply with the limitation on services and products contained in § 351.14.

6. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part and to prevent actual violations of section 13 of the BHC Act and this part. The banking entity's compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, including § 351.21, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity or investment indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

III. Responsibility and Accountability for the Compliance Program

a. A banking entity must establish, maintain, and enforce a governance and management framework to manage its business and employees with a view to preventing violations of section 13 of the BHC Act and this part. A banking entity must have an appropriate management framework reasonably designed to ensure that: Appropriate personnel are responsible and accountable for the effective implementation and enforcement of the compliance program; a clear reporting line with a chain of responsibility is delineated; and the compliance program is reviewed periodically by senior management. The board of directors (or equivalent governance body) and senior management should have the appropriate authority and access to personnel and information within the organizations as well as appropriate resources to conduct their oversight activities effectively.

1. *Corporate governance.* The banking entity must adopt a written compliance program approved by the board of directors, an appropriate committee of the board, or equivalent governance body, and senior management.

2. *Management procedures.* The banking entity must establish, maintain, and enforce a governance framework that is reasonably designed to achieve compliance with section 13 of the BHC Act and this part, which, at a minimum, provides for:

i. The designation of appropriate senior management or committee of senior management with authority to carry out the management responsibilities of the banking entity for each trading desk and for each organizational unit engaged in covered fund activities;

ii. Written procedures addressing the management of the activities of the banking entity that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, including:

A. A description of the management system, including the titles, qualifications, and locations of managers and the specific responsibilities of each person with respect to the banking entity's activities governed by section 13 of the BHC Act and this part; and

B. Procedures for determining compensation arrangements for traders engaged in underwriting or market making-related activities under § 351.4 or risk-mitigating hedging activities under § 351.5 so that such compensation arrangements are designed not to reward or incentivize prohibited proprietary trading and appropriately balance risk and financial results in a manner that does not encourage employees to expose the banking entity to excessive or imprudent risk.

3. *Business line managers.* Managers with responsibility for one or more trading desks of the banking entity are accountable for the effective implementation and enforcement of the compliance program with respect to the applicable trading desk(s).

4. *Board of directors, or similar corporate body, and senior management.* The board of directors, or similar corporate body, and senior management are responsible for setting and communicating an appropriate culture of compliance with section 13 of the BHC Act and this part and ensuring that appropriate policies regarding the management of trading activities and covered fund activities or investments are adopted to comply with section 13 of the BHC Act and this part. The board of directors or similar corporate body (such as a designated committee of the board or an equivalent governance body) must ensure that senior management is fully capable, qualified, and properly motivated to manage compliance with this part in light of the organization's business activities and the expectations of the board of directors. The board of directors or similar corporate body must also ensure that senior management has established appropriate incentives and adequate resources to support compliance with this part, including the implementation of a compliance program meeting the requirements of this appendix into management goals and compensation structures across the banking entity.

5. *Senior management.* Senior management is responsible for implementing and enforcing the approved compliance program. Senior management must also ensure that effective corrective action is taken when failures in compliance with section 13 of the BHC Act and this part are identified. Senior management and control personnel charged with overseeing compliance with section 13 of the BHC Act and this part should review the compliance program for the banking entity periodically and report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading activities and covered fund activities or investments, which shall be at least annually.

6. *CEO attestation.* Based on a review by the CEO of the banking entity, the CEO of the banking entity must, annually, attest in writing to the FDIC that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under this Appendix and § 351.20 of this part in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the United States operations of the foreign banking entity who is located in the United States.

IV. Independent Testing

a. Independent testing must occur with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading and covered fund activities or investments, which shall be at least annually. This independent testing must include an evaluation of:

1. The overall adequacy and effectiveness of the banking entity's compliance program, including an analysis of the extent to which the program contains all the required elements of this appendix;

2. The effectiveness of the banking entity's internal controls, including an analysis and documentation of instances in which such internal controls have been breached, and how such breaches were addressed and resolved; and

3. The effectiveness of the banking entity's management procedures.

b. A banking entity must ensure that independent testing regarding the effectiveness of the banking entity's compliance program is conducted by a qualified independent party, such as the banking entity's internal audit department, compliance personnel or risk managers independent of the organizational unit being tested, outside auditors, consultants, or other qualified independent parties. A banking entity must promptly take appropriate action to remedy any significant deficiencies or material weaknesses in its compliance program and to terminate any violations of section 13 of the BHC Act or this part.

V. Training

Banking entities must provide adequate training to personnel and managers of the banking entity engaged in activities or investments governed by section 13 of the BHC Act or this part, as well as other appropriate supervisory, risk, independent testing, and audit personnel, in order to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the banking entity's trading activities and covered fund activities or investments.

VI. Recordkeeping

Banking entities must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A banking entity must retain these records for a period that is no less than 5 years or such longer period as required by the FDIC in a form that allows it to promptly produce such records to the FDIC on request.

COMMODITY FUTURES TRADING COMMISSION

17 CFR Chapter I

Authority and Issuance

For the reasons stated in the Common Preamble, the Commodity Futures Trading Commission amends part 75 to chapter I of Title 17 Code of Federal Regulations as follows:

PART 75—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 46. The authority citation for part 75 continues to read as follows:

Authority: 12 U.S.C. 1851.

Subpart A—Authority and Definitions

■ 47. Section 75.2 is revised to read as follows:

§ 75.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraph (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal

Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in § 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include: (1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or (2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) Limited trading assets and liabilities means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 75.6(a)(1) and (2) of subpart B) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion; and

(ii) The CFTC has not determined pursuant to § 75.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (s)(3) of this section, trading assets and liabilities for purposes of this paragraph (s) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 75.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (s) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 75.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

(ii) For purposes of paragraph (s)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (s)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States, including branches outside the United States that are managed or controlled by a U.S. branch or agency of the foreign banking organization, for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(t) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(u) *Moderate trading assets and liabilities* means, with respect to a banking entity, that the banking entity does not have significant trading assets and liabilities or limited trading assets and liabilities.

(v) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(w) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(x) *Qualifying foreign banking organization* means a foreign banking organization that qualifies as such under § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(y) *SEC* means the Securities and Exchange Commission.

(z) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(aa) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(bb) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(cc) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(dd) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(ee) *Significant trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $20 billion; or

(ii) The CFTC has determined pursuant to § 75.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity, other than a banking entity described in paragraph (ee)(3) of this section, trading assets and liabilities for purposes of this paragraph (ee) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 75.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (ee) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 75.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States as well as branches outside the United States that are managed or controlled by a branch or agency of the foreign banking entity operating, located or organized in the United States).

(ii) For purposes of paragraph (ee)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (ee)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(ff) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(gg) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(hh) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ii) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

■ 48. Section 75.3 is amended by:

■ a. Revising paragraphs (b), and (d)(3), (8), and (9);

■ b. Adding paragraphs (d)(10) through (13);

■ c. Redesignating paragraphs (e)(5) through (13) as paragraphs (e)(6) through (14);

■ d. Adding new paragraph (e)(5); and

■ e. Revising paragraph (e)(11), (12), and (14).

The revisions and additions read as follows:

§ 75.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account.* (1) *Trading account.* Trading account means:

(i) Any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from the purchases or sales of financial instruments described in this paragraph;

(ii) Any account that is used by a banking entity to purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, 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; or

(iii) Any account that is used by a banking entity to purchase or sell one or more financial instruments, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Trading account application for certain banking entities.* (i) A banking entity that is subject to paragraph (b)(1)(ii) of this section in determining the scope of its trading account is not subject to paragraph (b)(1)(i) of this section.

(ii) A banking entity that does not calculate risk-based capital ratios under the market risk capital rule and is not a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk based capital ratios under the market risk capital rule may elect to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph. A banking entity that elects under this subsection to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph is not required to apply paragraph (b)(1)(i) of this section.

(3) *Consistency of account election for certain banking entities.* (i) Any election or change to an election under paragraph (b)(2)(ii) of this section must apply to the electing banking entity and all of its wholly owned subsidiaries. The primary financial regulatory agency of a banking entity that is affiliated with but is not a wholly owned subsidiary of such electing banking entity may require that the banking entity be subject to this uniform application requirement if the primary financial regulatory agency determines that it is necessary to prevent evasion of the requirements of this part after notice and opportunity for response as provided in subpart D of this part.

(ii) A banking entity that does not elect under paragraph (b)(2)(ii) of this section to be subject to the trading account definition in (b)(1)(ii) may continue to apply the trading account definition in paragraph (b)(1)(i) of this section for one year from the date on which it becomes, or becomes a consolidated affiliate for regulatory reporting purposes with, a banking entity that calculates risk-based capital ratios under the market risk capital rule.

(4) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed not to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for sixty days or longer and does not transfer substantially all of the risk of the financial instrument within sixty days of the purchase (or sale).

* * * * *

(d) * * *

(3) Any purchase or sale of a security, foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), or cross-currency swap by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular financial instruments to be used for liquidity management purposes, the amount, types, and risks of these financial instruments that are consistent with liquidity management, and the liquidity circumstances in which the particular financial instruments may or must be used;

(ii) Requires that any purchase or sale of financial instruments contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any financial instruments purchased or sold for liquidity management purposes be highly liquid and limited to financial instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any financial instruments purchased or sold for liquidity management purposes, together with any other financial instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under § 75.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in this paragraph (d)(3); and

(vi) Is consistent with the CFTC's regulatory requirements regarding liquidity management;

* * * * *

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity;

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the OCC;

(10) Any purchase or sale of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error;

(11) Contemporaneously entering into a customer-driven swap or customer-driven security-based swap and a matched swap or security-based swap if:

(i) The banking entity retains no more than minimal price risk; and

(ii) The banking entity is not a registered dealer, swap dealer, or security-based swap dealer;

(12) Any purchase or sale of one or more financial instruments that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy; or

(13) Any purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form for a banking entity as of January 1, 2020.

(e) * * *

(5) *Cross-currency swap* means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

* * * * *

(11) *Market risk capital rule covered position and trading position* means a financial instrument that meets the criteria to be a covered position and a trading position, as those terms are respectively defined, without regard to whether the financial instrument is reported as a covered position or trading position on any applicable regulatory reporting forms:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(12) *Market risk capital rule* means the market risk capital rule that is contained in 12 CFR part 3, subpart F, with respect to a banking entity for which the OCC is the primary financial regulatory agency, 12 CFR part 217 with respect to a banking entity for which the Board is the primary financial regulatory agency, or 12 CFR part 324 with respect to a banking entity for which the FDIC is the primary financial regulatory agency.

* * * * *

(14) *Trading desk* means a 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 that is:

(i)(A) Structured by the banking entity to implement a well-defined business strategy;

(B) Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies; and

(C) Characterized by a clearly defined unit that:

(1) Engages in coordinated trading activity with a unified approach to its key elements;

(2) Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;

(3) Submits compliance reports and other information as a unit for monitoring by management; and

(4) Books its trades together; or

(ii) For a banking entity that calculates risk-based capital ratios under the market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the market risk capital rule.

■ 49. Section 75.4 is revised to read as follows:

§ 75.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 75.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii)(A) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities; and

(B) Reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with paragraph (a)(2)(ii)(A) of this section;

(C) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (a)(2))iii)(B) and (C) of this section by complying with the requirements set forth below in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a distribution of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this section, *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 75.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure, routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The trading desk's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, in accordance with paragraph (b)(2)(ii) of this section;

(D) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(E) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (b)(2)(iii)(C) and (D) of this section by complying with the requirements set forth below in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with the methodology described in § 75.2(ee) of this part, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(ii) [Reserved]

(4) *Definition of financial exposure.* For purposes of this section, *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker positions.* For the purposes of this section, *market-maker positions* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

(c) *Rebuttable presumption of compliance*—(1) *Internal limits.* (i) A banking entity shall be presumed to meet the requirement in paragraph (a)(2)(ii)(A) or (b)(2)(ii) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the internal limits for the relevant trading desk as described in paragraph (c)(1)(ii) of this section.

(ii)(A) With respect to underwriting activities conducted pursuant to paragraph (a) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of securities and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's underwriting activities, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held.

(B) With respect to market making-related activities conducted pursuant to paragraph (b) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's market-making related activities, that address the:

(*1*) Amount, types, and risks of its market-maker positions;

(2) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(3) Level of exposures to relevant risk factors arising from its financial exposure; and

(4) Period of time a financial instrument may be held.

(2) *Supervisory review and oversight.* The limits described in paragraph (c)(1) of this section shall be subject to supervisory review and oversight by the CFTC on an ongoing basis.

(3) *Limit Breaches and Increases.* (i) With respect to any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, a banking entity shall maintain and make available to the CFTC upon request records regarding:

(A) Any limit that is exceeded; and

(B) Any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the CFTC.

(ii) In the event of a breach or increase of any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, the presumption described in paragraph (c)(1)(i) of this section shall continue to be available only if the banking entity:

(A) Takes action as promptly as possible after a breach to bring the trading desk into compliance; and

(B) Follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval.

(4) *Rebutting the presumption.* The presumption in paragraph (c)(1)(i) of this section may be rebutted by the CFTC if the CFTC determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The CFTC's rebuttal of the presumption in paragraph (c)(1)(i) of this section must be made in accordance with the notice and response procedures in subpart D of this part.

■ 50. Section 75.5 is amended by revising paragraphs (b) and (c)(1) introductory text and adding paragraph (c)(4) to read as follows:

§ 75.5 Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements.* (1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * *

(1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not

apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

■ 51. Section 75.6 is amended by revising paragraph (e)(3); removing paragraphs (e)(4) and (6); and redesignating paragraph (e)(5) as paragraph (e)(4).

The revision reads as follows:

§ 75.6 Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including relevant personnel) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

Subpart C—Covered Funds Activities and Investments

■ 52. Section 75.10 is amended by revising paragraphs (c)(7)(ii) and (c)(8)(i)(A) to read as follows:

§ 75.10 Prohibition on Acquiring or Retaining an Ownership Interest in and Having Certain Relationships with a Covered Fund

* * * * *

(c) * * *

(7) * * *

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable requirements regarding bank owned life insurance.

(8) * * *

(i) * * *

(A) Loans as defined in § 75.2(t) of subpart A;

* * * * *

■ 53. Section 75.11 is amended by revising paragraph (c) to read as follows:

§ 75.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 75.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 75.4(a) or (b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 75.12(a)(2)(ii); § 75.12(a)(2)(iii), and § 75.12(d) of this subpart.

■ 54. Section 75.13 is amended by revising paragraphs (a), (b)(3) and (4), and (c) to read as follows:

§ 75.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 75.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program in accordance with subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising:

(*1*) Out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund; or

(*2*) In connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) With respect to risk-mitigating hedging activity conducted pursuant to paragraph (a)(1)(i) of this section, the compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to paragraph (a)(1)(i) and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) * * *

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of this paragraph (b)(3) to participate in any offer or sale by the covered fund of ownership interests in the covered fund.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 75.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws and regulations of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law or regulation described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

■ 55. Section 75.14 is amended by revising paragraph (a)(2)(ii)(B) to read as follows:

§ 75.14 Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the CFTC (with a duty to update the certification if the information in the certification materially changes) 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; and

* * * * *

Subpart D—Compliance Program Requirement; Violations

■ 56. Section 75.20 is amended by revising paragraphs (a), (b) introductory text, (c), (d), (e) introductory text, and (f)(2) and adding paragraphs (g), (h), and (i) to read as follows:

§ 75.20 Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) 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 this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) Banking entities with significant trading assets and liabilities. With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation.* The CEO of a banking entity that has significant trading assets and liabilities must, based on a review by the CEO of the banking entity, attest in writing to the CFTC, each year no later than March 31, that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program required by paragraph (b) of this section in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States.

(d) Reporting requirements under appendix A to this part. (1) A banking entity engaged in proprietary trading activity permitted under subpart B of this part shall comply with the reporting requirements described in appendix A to this part, if:

(i) The banking entity has significant trading assets and liabilities; or

(ii) The CFTC notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A to this part.

(2) Frequency of reporting: Unless the CFTC notifies the banking entity in writing that it must report on a different basis, a banking entity subject to appendix A to this part shall report the information required by appendix A for

each quarter within 30 days of the end of the quarter.

(e) *Additional documentation for covered funds.* A banking entity with significant trading assets and liabilities shall maintain records that include:

* * * * *

(f) * * *

(2) *Banking entities with moderate trading assets and liabilities.* A banking entity with moderate trading assets and liabilities may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.

(g) *Rebuttable presumption of compliance for banking entities with limited trading assets and liabilities*—(1) *Rebuttable presumption.* Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities shall be presumed to be compliant with subpart B and subpart C of this part and shall have no obligation to demonstrate compliance with this part on an ongoing basis.

(2) *Rebuttal of presumption.* If upon examination or audit, the CFTC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C of this part, the CFTC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities. The CFTC's rebuttal of the presumption in this paragraph must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the CFTC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the CFTC determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C, of this part does not warrant a presumption of compliance under paragraph (g) of this section or treatment as a banking entity with moderate trading assets and liabilities, as applicable. The CFTC's exercise of this reservation of authority must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(i) *Notice and response procedures*—(1) *Notice.* The CFTC will notify the banking entity in writing of any determination requiring notice under this part and will provide an explanation of the determination.

(2) *Response.* The banking entity may respond to any or all items in the notice described in paragraph (i)(1) of this section. The response should include any matters that the banking entity would have the CFTC consider in deciding whether to make the determination. The response must be in writing and delivered to the designated CFTC official within 30 days after the date on which the banking entity received the notice. The CFTC may shorten the time period when, in the opinion of the CFTC, the activities or condition of the banking entity so requires, provided that the banking entity is informed of the time period at the time of notice, or with the consent of the banking entity. In its discretion, the CFTC may extend the time period for good cause.

(3) *Waiver.* Failure to respond within 30 days or such other time period as may be specified by the CFTC shall constitute a waiver of any objections to the CFTC's determination.

(4) *Decision.* The CFTC will notify the banking entity of the decision in writing. The notice will include an explanation of the decision.

■ 57. Revise appendix A to part 75 to read as follows:

Appendix A to Part 75—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 75.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the CFTC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 75.20.

b. The purpose of this appendix is to assist banking entities and the CFTC in:

(1) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(2) Monitoring the banking entity's covered trading activities;

(3) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(4) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 75.4(b) are consistent with the requirements governing permitted market making-related activities;

(5) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to § 75.4, 75.5, or 75.6(a) and (b) (*i.e.,* underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(6) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by CFTC of such activities; and

(7) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is not intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 75.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 75.4 through 75.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to CFTC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 75.2 and 75.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under § 75.4, § 75.5, § 75.6(a), or § 75.6(b). A banking entity may include in its covered trading activity trading conducted under § 75.3(d), § 75.6(c), § 75.6(d) or § 75.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. Quantitative measurements. Each banking entity made subject to this appendix by § 75.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Internal Limits and Usage;
ii. Value-at-Risk;
iii. Comprehensive Profit and Loss Attribution;
iv. Positions; and
v. Transaction Volumes.

2. Trading desk information. Each banking entity made subject to this appendix by § 75.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. Quantitative measurements identifying information. Each banking entity made subject to this appendix by § 75.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. Narrative statement. Each banking entity made subject to this appendix by § 75.20 may provide an optional narrative statement, as further described in this appendix.

5. File identifying information. Each banking entity made subject to this appendix by § 75.20 must provide file identifying information in each submission to the CFTC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. Trading Desk Information

1. Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

i. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;

ii. Identification of each type of covered trading activity in which the trading desk is engaged;

iii. Brief description of the general strategy of the trading desk;

v. A list identifying each Agency receiving the submission of the trading desk;

2. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and

3. Currency reported and daily currency conversion rate.

c. Quantitative Measurements Identifying Information

Each banking entity must provide the following information regarding the quantitative measurements:

1. An Internal Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Internal Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, the unit of measurement for the limit, the type of limit, and identification of the corresponding risk factor attribution in the particular case that the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and

2. A Risk Factor Attribution Information Schedule that provides identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement, including the name of the risk factor or other factor, a unique identification label for the risk factor or other factor, a description of the risk factor or other factor, and the risk factor or other factor's change unit.

d. Narrative Statement

Each banking entity made subject to this appendix by § 75.20 may submit in a separate electronic document a Narrative Statement to the CFTC with any information the banking entity views as relevant for assessing the information reported. The Narrative Statement may include further description of or changes to calculation methods, identification of material events, description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such changes occurred.

e. Frequency and Method of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the CFTC on the reporting schedule established in § 75.20 unless otherwise requested by the CFTC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the CFTC in accordance with the XML Schema specified and published on the CFTC's website.

f. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the CFTC pursuant to this appendix and § 75.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the CFTC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the CFTC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Internal Limits and Usage

i. *Description:* For purposes of this appendix, Internal Limits are 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. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Internal limits and their usage are key compliance and risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in §§ 75.4 and 75.5. A trading desk's risk limits, commonly including a limit on ''Value-at-Risk,'' are useful in the broader context of the trading desk's overall activities, particularly for the market making activities under § 75.4(b) and hedging activity under § 75.5. Accordingly, the limits required under §§ 75.4(b)(2)(iii)(C) and 75.5(b)(1)(i)(A) must meet the applicable requirements under §§ 75.4(b)(2)(iii)(C) and 75.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, ''Value-at-Risk'' except to the extent the ''Value-at-Risk'' metric is demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

A. A banking entity must provide the following information for each limit reported pursuant to this quantitative measurement: The unique identification label for the limit reported in the Internal Limits Information Schedule, the limit size (distinguishing between an upper and a lower limit), and the value of usage of the limit.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

2. Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the measurement of the risk of future financial loss in the value of a trading desk's aggregated positions at the ninety-nine percent confidence level over a one-day period, based on current market conditions.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into two categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); and (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions'').

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to (i) changes in the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. For the attribution of comprehensive profit and loss from existing positions to specific risk factors and other factors, a banking entity must provide the following information for the factors that explain the preponderance of the profit or loss changes due to risk factor changes: The unique identification label for the risk factor or other factor listed in the Risk Factor Attribution Information Schedule, and the profit or loss due to the risk factor or other factor change.

C. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

D. The portion of comprehensive profit and loss from existing positions that is not attributed to changes in specific risk factors and other factors must be allocated to a residual category. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

c. Positions and Transaction Volumes Measurements

1. Positions

i. *Description:* For purposes of this appendix, Positions is the value of securities and derivatives positions managed by the trading desk. For purposes of the Positions quantitative measurement, do not include in the Positions calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [1227] A banking entity must separately report the trading desk's market value of long securities positions, short securities positions, derivatives receivables, and derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 75.4(a) or (b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description:* For purposes of this appendix, Transaction Volumes measures three exclusive categories of covered trading activity conducted by a trading desk. A banking entity is required to report the value and number of security and derivative transactions conducted by the trading desk with: (i) Customers, excluding internal transactions; (ii) non-customers, excluding internal transactions; and (iii) trading desks and other organizational units where the transaction is booked into either the same banking entity or an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [1228] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 75.4(a) to conduct underwriting activity is a market participant identified in § 75.4(a)(7), and a customer of a trading desk that relies on § 75.4(b) to conduct market making-related activity is a market participant identified in § 75.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 75.4(a) or (b) to conduct underwriting activity or market-making-related activity, respectively.

[1227] *See* § 75.2(h), (aa). For example, under this part, a security-based swap is both a ''security'' and a ''derivative.'' For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.

[1228] *See* § 75.2(h), (aa).

Appendix B to Part 75 [Removed]

■ 58. Appendix B to part 75 is removed.

■ 59. Effective January 1, 2020, until December 31, 2020, appendix Z to part 75 is added to read as follows:

Appendix Z to Part 75—Proprietary Trading and Certain Interests in and Relationships with Covered Funds (Alternative Compliance)

Note: The content of this appendix reproduces the regulation implementing Section 13 of the Bank Holding Company Act as of November 13, 2019.

Subpart A—Authority and Definitions

§ 75.1 Authority, purpose, scope, and relationship to other authorities.

(a) *Authority.* This part is issued by the Commission under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851).

(b) *Purpose.* Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading by, and investments in or relationships with covered funds by, certain banking entities. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and further explaining the statute's requirements.

(c) *Scope.* This part implements section 13 of the Bank Holding Company Act with respect to banking entities for which the CFTC is the primary financial regulatory agency, as defined in section 2(12) of the Dodd-Frank Act, but does not include such entities to the extent they are not within the definition of banking entity in § 75.2(c).

(d) *Relationship to other authorities.* Except as otherwise provided under section 13 of the BHC Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of the BHC Act shall apply to the activities of an applicable banking entity, even if such activities are authorized for the applicable banking entity under other applicable provisions of law.

§ 75.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the

Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* or *Commission* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) Insured depository institution, unless otherwise indicated, has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(t) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(u) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(v) Qualifying foreign banking organization means a foreign banking organization that qualifies as such under § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(w) *SEC* means the Securities and Exchange Commission.

(x) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(y) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(z) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(aa) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(bb) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(cc) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(dd) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ee) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ff) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

§ 75.3 Prohibition on proprietary trading.

(a) *Prohibition.* Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. *Proprietary trading* means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

(b) *Definition of trading account.* (1) Trading account means any account that is used by a banking entity to:

(i) Purchase or sell one or more financial instruments principally for the purpose of:

(A) Short-term resale;

(B) Benefitting from actual or expected short-term price movements;

(C) Realizing short-term arbitrage profits; or

(D) Hedging one or more positions resulting from the purchases or sales of financial instruments described in paragraphs (b)(1)(i)(A), (B), or (C) of this section;

(ii) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(iii) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale), unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section.

(c) *Financial instrument*—(1) *Financial instrument* means:

(i) A security, including an option on a security;

(ii) A derivative, including an option on a derivative; or

(iii) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(2) A financial instrument does not include:

(i) A loan;

(ii) A commodity that is not:

(A) An excluded commodity (other than foreign exchange or currency);

(B) A derivative;

(C) A contract of sale of a commodity for future delivery; or

(D) An option on a contract of sale of a commodity for future delivery; or

(iii) Foreign exchange or currency.

(d) *Proprietary trading does not include:*—(1) Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(2) Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(3) Any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular securities to be used for liquidity management purposes, the amount, types, and risks of these securities that are consistent with liquidity management, and the liquidity circumstances in which the particular securities may or must be used;

(ii) Requires that any purchase or sale of securities contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any securities purchased or sold for liquidity management purposes be highly liquid and limited to securities the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any securities purchased or sold for liquidity management purposes, together with any other instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of securities that are not permitted under § 75.6(a) or (b) are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (d)(3) of this section; and

(vi) Is consistent with the Commission's supervisory requirements, guidance, and expectations regarding liquidity management;

(4) Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments;

(5) Any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(6) Any purchase or sale of one or more financial instruments by a banking entity, so long as:

(i) The purchase (or sale) satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or

(ii) The purchase (or sale) satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding;

(7) Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian;

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity; or

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the Commission.

(e) *Definition of other terms related to proprietary trading.* For purposes of this subpart:

(1) *Anonymous* means that each party to a purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale.

(2) *Clearing agency* has the same meaning as in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(3) *Commodity* has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(4) *Contract of sale of a commodity for future delivery* means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27))).

(5) Derivatives clearing organization means:

(i) A derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1);

(ii) A derivatives clearing organization that, pursuant to CFTC regulation, is exempt from the registration requirements under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1); or

(iii) A foreign derivatives clearing organization that, pursuant to CFTC regulation, is permitted to clear for a foreign board of trade that is registered with the CFTC.

(6) *Exchange,* unless the context otherwise requires, means any designated contract market, swap execution facility, or foreign board of trade registered with the CFTC, or, for purposes of securities or security-based swaps, an exchange, as defined under section 3(a)(1) of the Exchange Act (15 U.S.C. 78c(a)(1)), or security-based swap execution facility, as defined under section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)).

(7) *Excluded clearing activities* means:

(i) With respect to customer transactions cleared on a derivatives clearing organization, a clearing agency, or a designated financial market utility, any purchase or sale necessary to correct trading errors made by or on behalf of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(ii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a designated financial market utility; and

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

(8) Designated financial market utility has the same meaning as in section 803(4) of the Dodd-Frank Act (12 U.S.C. 5462(4)).

(9) *Issuer* has the same meaning as in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(10) *Market risk capital rule covered position and trading position* means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(11) *Market risk capital rule* means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

(12) *Municipal security* means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

(13) *Trading desk* means 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.

§ 75.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 75.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with paragraph (a) of this section.

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held;

(C) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(D) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

(iv) The compensation arrangements of persons performing the activities described in paragraph (a) of this section are designed not to reward or incentivize prohibited proprietary trading; and

(v) The banking entity is licensed or registered to engage in the activity described in paragraph (a) of this section in accordance with applicable law.

(3) *Definition of distribution.* For purposes of paragraph (a) of this section, a *distribution* of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of paragraph (a) of this section, *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of paragraph (a) of this section, *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of paragraph (a) of this section, *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of paragraph (a) of this section, the terms *client, customer,* and *counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 75.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with paragraph (b) of this section.

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on:

(A) The liquidity, maturity, and depth of the market for the relevant types of financial instrument(s); and

(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section, on:

(*1*) The amount, types, and risks of its market-maker inventory;

(*2*) The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) The level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) The period of time a financial instrument may be held;

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of paragraph (b) of this section, and independent review of such demonstrable analysis and approval;

(iv) To the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in paragraph (b) of this section are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in paragraph (b) of this section in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer,* and *counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 75.20(d)(1), unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(ii) [Reserved]

(4) *Definition of financial exposure.* For purposes of paragraph (b) of this section, *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker inventory.* For the purposes of paragraph (b) of this section, *market-maker inventory* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

§ 75.5 Permitted risk-mitigating hedging activities.

(a) *Permitted risk-mitigating hedging activities.* The prohibition contained in § 75.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(1) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(i) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(ii) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(iii) The conduct of analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged;

(2) The risk-mitigating hedging activity:

(i) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(ii) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(iii) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(iv) Is subject to continuing review, monitoring and management by the banking entity that:

(A) Is consistent with the written hedging policies and procedures required under paragraph (b)(1) of this section;

(B) Is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(C) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading; and

(3) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(c) *Documentation requirement.* (1) A banking entity must comply with the requirements of paragraphs (c)(2) and (c)(3) of this section with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

(i) Not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce;

(ii) Established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but that is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures established under paragraph (b)(1) of this section or under § 75.4(b)(2)(iii)(B) as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or

(iii) Established to hedge aggregated positions across two or more trading desks.

(2) In connection with any purchase or sale identified in paragraph (c)(1) of this section, a banking entity must, at a minimum, and contemporaneously with the purchase or sale, document:

(i) The specific, identifiable risk(s) of the identified positions, contracts, or other holdings of the banking entity that the purchase or sale is designed to reduce;

(ii) The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and

(iii) The trading desk or other business unit that is establishing and responsible for the hedge.

(3) A banking entity must create and retain records sufficient to demonstrate compliance with the requirements of paragraph (c) of this section for a period that is no less than five years in a form that allows the banking entity to promptly produce such records to the Commission on request, or such longer period as required under other law or this part.

§ 75.6 Other permitted proprietary trading activities.

(a) *Permitted trading in domestic government obligations.* The prohibition contained in § 75.3(a) does not apply to the purchase or sale by a banking entity of a financial instrument that is:

(1) An obligation of, or issued or guaranteed by, the United States;

(2) An obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*);

(3) An obligation of any State or any political subdivision thereof, including any municipal security; or

(4) An obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(b) *Permitted trading in foreign government obligations*—(1) *Affiliates of foreign banking entities in the United States.* The prohibition contained in § 75.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as:

(i) The banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in paragraph (b)(1)(i) of this section is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The purchase or sale as principal is not made by an insured depository institution.

(2) *Foreign affiliates of a U.S. banking entity.* The prohibition contained in § 75.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as:

(i) The foreign entity is a foreign bank, as defined in § 211.2(j) of the Board's Regulation K (12 CFR 211.2(j)), or is regulated by the foreign sovereign as a securities dealer;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

(c) Permitted trading on behalf of customers—(1) *Fiduciary transactions.* The prohibition contained in § 75.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as trustee or in a similar fiduciary capacity, so long as:

(i) The transaction is conducted for the account of, or on behalf of, a customer; and

(ii) The banking entity does not have or retain beneficial ownership of the financial instruments.

(2) *Riskless principal transactions.* The prohibition contained in § 75.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(d) Permitted trading by a regulated insurance company. The prohibition contained in § 75.3(a) does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if:

(1) The insurance company or its affiliate purchases or sells the financial instruments solely for:

(i) The general account of the insurance company; or

(ii) A separate account established by the insurance company;

(2) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (d)(2) of this section is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

(e) *Permitted trading activities of foreign banking entities.* (1) The prohibition contained in § 75.3(a) does not apply to the purchase or sale of financial instruments by a banking entity if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State;

(ii) The purchase or sale by the banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale meets the requirements of paragraph (e)(3) of this section.

(2) A purchase or sale of financial instruments by a banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (e)(1)(ii) of this section only if:

(i) The purchase or sale is conducted in accordance with the requirements of paragraph (e) of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of any State and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(*1*) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(*2*) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(*3*) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) A purchase or sale by a banking entity is permitted for purposes of paragraph (e) of this section only if:

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State;

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;

(iv) 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 the laws of the United States or of any State; and

(v) The purchase or sale is not conducted with or through any U.S. entity, other than:

(A) A purchase or sale with the foreign operations of a U.S. entity if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;

(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty,

(4) For purposes of paragraph (e) of this section, a U.S. entity is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of paragraph (e) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(6) For purposes of paragraph (e) of this section, *unaffiliated market*

intermediary means an unaffiliated entity, acting as an intermediary, that is:

(i) A broker or dealer registered with the SEC under section 15 of the Exchange Act or exempt from registration or excluded from regulation as such;

(ii) A swap dealer registered with the CFTC under section 4s of the Commodity Exchange Act or exempt from registration or excluded from regulation as such;

(iii) A security-based swap dealer registered with the SEC under section 15F of the Exchange Act or exempt from registration or excluded from regulation as such; or

(iv) A futures commission merchant registered with the CFTC under section 4f of the Commodity Exchange Act or exempt from registration or excluded from regulation as such.

§ 75.7 Limitations on permitted proprietary trading activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 75.4 through 75.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§§ 75.8–75.9 [Reserved]

Subpart C—Covered Fund Activities and Investments

§ 75.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) *Prohibition.* (1) Except as otherwise provided in this subpart, a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(2) Paragraph (a)(1) of this section does not include acquiring or retaining an ownership interest in a covered fund by a banking entity:

(i) Acting solely as agent, broker, or custodian, so long as;

(A) The activity is conducted for the account of, or on behalf of, a customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest;

(ii) Through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof) that is established and administered in accordance with the law of the United States or a foreign sovereign, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);

(iii) In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event may the banking entity retain such ownership interest for longer than such period permitted by the Commission; or

(iv) On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as:

(A) The activity is conducted for the account of, or on behalf of, the customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest.

(b) *Definition of covered fund.* (1) Except as provided in paragraph (c) of this section, covered fund means:

(i) An issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), *but for* section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a–3(c)(1) or (7));

(ii) Any commodity pool under section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10)) for which:

(A) The commodity pool operator has claimed an exemption under § 4.7 of this chapter; or

(B)(*1*) A commodity pool operator is registered with the CFTC as a commodity pool operator in connection with the operation of the commodity pool;

(*2*) Substantially all participation units of the commodity pool are owned by qualified eligible persons under § 4.7(a)(2) and (3) of this chapter; and

(*3*) Participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons under § 4.7(a)(2) and (3) of this chapter; or

(iii) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, an entity that:

(A) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(B) Is, or holds 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; and

(C)(*1*) Has as its sponsor that banking entity (or an affiliate thereof); or

(*2*) Has issued an ownership interest that is owned directly or indirectly by that banking entity (or an affiliate thereof).

(2) An issuer shall not be deemed to be a covered fund under paragraph (b)(1)(iii) of this section if, were the issuer subject to U.S. securities laws, the issuer could rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act.

(3) For purposes of paragraph (b)(1)(iii) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(c) Notwithstanding paragraph (b) of this section, unless the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine otherwise, a covered fund does not include:

(1) *Foreign public funds.* (i) Subject to paragraphs (c)(1)(ii) and (iii) of this section, an issuer that:

(A) Is organized or established outside of the United States;

(B) Is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and

(C) Sells ownership interests predominantly through one or more public offerings outside of the United States.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and employees of such entities.

(iii) For purposes of paragraph (c)(1)(i)(C) of this section, the term *public offering* means a distribution (as defined in § 75.4(a)(3)) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(B) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(C) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

(2) *Wholly-owned subsidiaries.* An entity, all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate thereof), except that:

(i) Up to five percent of the entity's outstanding ownership interests, less any amounts outstanding under paragraph (c)(2)(ii) of this section, may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and

(ii) Up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(3) *Joint ventures.* A joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, *provided that* the joint venture:

(i) Is comprised of no more than 10 unaffiliated co-venturers;

(ii) 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

(iii) 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.

(4) *Acquisition vehicles.* An issuer:

(i) Formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction; and

(ii) That exists only for such period as necessary to effectuate the transaction.

(5) *Foreign pension or retirement funds.* A plan, fund, or program providing pension, retirement, or similar benefits that is:

(i) Organized and administered outside the United States;

(ii) A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and

(iii) Established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.

(6) *Insurance company separate accounts.* A separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses.

(7) *Bank owned life insurance.* A separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is beneficiary, provided that no banking entity that purchases the policy:

(i) Controls the investment decisions regarding the underlying assets or holdings of the separate account; or

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank owned life insurance.

(8) *Loan securitizations*—(i) *Scope.* An issuing entity for asset-backed securities that satisfies all the conditions of paragraph (c)(8) of this section and the assets or holdings of which are comprised solely of:

(A) Loans as defined in § 75.2(s);

(B) 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 paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(ii) *Impermissible assets.* For purposes of paragraph (c)(8) of this section, the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraph (c)(8)(iii) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities.* Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives.* The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivative directly relate to the loans, the asset-backed securities, or the contractual rights of other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates.* The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in paragraph (c)(8) of this section;

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under paragraph (c)(8) of this section and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

(9) *Qualifying asset-backed commercial paper conduits.* (i) An issuing entity for asset-backed commercial paper that satisfies all of the following requirements:

(A) The asset-backed commercial paper conduit holds only:

(*1*) Loans and other assets permissible for a loan securitization under paragraph (c)(8)(i) of this section; and

(*2*) Asset-backed securities supported solely by assets that are permissible for loan securitizations under paragraph (c)(8)(i) of this section and acquired by the asset-backed commercial paper conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or directly from an underwriter in the distribution of the asset-backed securities;

(B) The asset-backed commercial paper conduit issues only asset-backed securities, comprised of a residual interest and securities with a legal maturity of 397 days or less; and

(C) A regulated liquidity provider has entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding asset-backed securities issued by the asset-backed commercial paper conduit (other than any residual interest) in the event that funds are required to redeem maturing asset-backed securities.

(ii) For purposes of this paragraph (c)(9) of this section, a regulated liquidity provider means:

(A) A depository institution, as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(B) A bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a subsidiary thereof;

(C) A savings and loan holding company, as defined in section 10a of the Home Owners' Loan Act (12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), or a subsidiary thereof;

(D) A foreign bank whose home country supervisor, as defined in § 211.21(q) of the Board's Regulation K (12 CFR 211.21(q)), has adopted capital standards consistent with the Capital Accord for the Basel Committee on Banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(E) The United States or a foreign sovereign.

(10) *Qualifying covered bonds*—(i) *Scope.* An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are comprised solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

(ii) *Covered bond.* For purposes of paragraph (c)(10) of this section, a covered bond means:

(A) A debt obligation issued by an entity that meets the definition of foreign banking organization, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section; or

(B) A debt obligation of an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section, provided that the payment obligations are fully and unconditionally guaranteed by an entity that meets the definition of foreign banking organization and the entity is a wholly-owned subsidiary, as defined in paragraph (c)(2) of this section, of such foreign banking organization.

(11) *SBICs and public welfare investment funds.* An issuer:

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked; or

(ii) The business of which is to make investments that are:

(A) Designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(12) *Registered investment companies and excluded entities.* An issuer:

(i) 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 as described in § 75.20(e)(3) and that complies with the requirements of section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a–18);

(ii) That may rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act; or

(iii) That has elected to be regulated as a business development company 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 business development company as described in § 75.20(e)(3) and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a–60).

(13) Issuers in conjunction with the FDIC's receivership or conservatorship operations. An issuer that is an entity formed by or on behalf of the FDIC for the purpose of facilitating the disposal of assets acquired in the FDIC's capacity as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(14) *Other excluded issuers.* (i) Any issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act.

(ii) A determination made under paragraph (c)(14)(i) of this section will be promptly made public.

(d) *Definition of other terms related to covered funds.* For purposes of this subpart:

(1) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the Commission determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(2) *Asset-backed security* has the meaning specified in section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)).

(3) *Director* has the same meaning as provided in § 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

(4) *Issuer* has the same meaning as in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(22)).

(5) *Issuing entity* means with respect to asset-backed securities the special purpose vehicle that owns or holds the pool assets underlying asset-backed securities and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

(6) *Ownership interest*—(i) *Ownership interest* means any equity, partnership, or other similar interest. An ''other similar interest'' means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs (d)(6)(i)(A) through (d)(6)(i)(F) of this section.

(ii) *Ownership interest* does not include *restricted profit interest,* which is an interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(A) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(B) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(C) Any amounts invested in the covered fund, including any amounts paid by the entity (or employee or former employee thereof) in connection with obtaining the restricted profit interest, are within the limits of § 75.12; and

(D) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

(7) *Prime brokerage transaction* means 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.

(8) Resident of the United States means a person that is a ''U.S. person'' as defined in rule 902(k) of the SEC's Regulation S (17 CFR 230.902(k)).

(9) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name, except as permitted under § 75.11(a)(6).

(10) *Trustee.* (i) For purposes of paragraph (d)(9) of this section and § 75.11, a trustee does *not* include:

(A) A trustee that does not exercise investment discretion with respect to a covered fund, including a trustee that is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)); or

(B) A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to those described in paragraph (d)(10)(i)(A) of this section;

(ii) Any entity that directs a person described in paragraph (d)(10)(i) of this section, or that possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee, shall be considered to be a trustee of such covered fund.

§ 75.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

(a) *Organizing and offering a covered fund in general.* Notwithstanding § 75.10(a), a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund in connection with, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, only if:

(1) The banking entity (or an affiliate thereof) provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services;

(2) The covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity (or an affiliate thereof), pursuant to a written plan or similar documentation outlining how the banking entity or such affiliate intends to provide advisory or similar services to its customers through organizing and offering such fund;

(3) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under § 75.12;

(4) The banking entity and its affiliates comply with the requirements of § 75.14;

(5) The banking entity and its affiliates do 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;

(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof), except that a covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

(A) The investment adviser is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(B) The investment adviser does not share the same name or a variation of the same name as an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(ii) Does not use the word ''bank'' in its name;

(7) No director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity or such affiliate who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

(8) The banking entity:

(i) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(A) That ''any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity] or its affiliates; therefore, [the banking entity's] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity] and any affiliate in its capacity as investor in the [covered fund] or as beneficiary of a restricted profit interest held by [the banking entity] or any affiliate'';

(B) That such investor should read the fund offering documents before investing in the covered fund;

(C) That the ''ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity'' (unless that happens to be the case); and

(D) The role of the banking entity and its affiliates and employees in sponsoring or providing any services to the covered fund; and

(ii) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates.

(b) Organizing and offering an issuing entity of asset-backed securities. (1) Notwithstanding § 75.10(a), a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuing entity of asset-backed securities in connection with, directly or indirectly, organizing and offering that issuing entity, so long as the banking entity and its affiliates comply with all of the requirements of paragraphs (a)(3) through (a)(8) of this section.

(2) For purposes of paragraph (b) of this section, organizing and offering a covered fund that is an issuing entity of asset-backed securities means acting as the securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)) of the issuing entity, or acquiring or retaining an ownership interest in the issuing entity as required by section 15G of that Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder.

(c) Underwriting and market making in ownership interests of a covered fund. The prohibition contained in § 75.10(a) does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 75.4(a) or (b), respectively;

(2) With respect to any banking entity (or any affiliate thereof) that acts as a

sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section; or, directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 75.12(a)(2)(ii) and (d); and

(3) With respect to any banking entity, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under § 75.11, including all covered funds in which the banking entity holds an ownership interest in connection with underwriting and market making related activities permitted under paragraph (c) of this section, are included in the calculation of all ownership interests under § 75.12(a)(2)(iii) and (d).

§ 75.12 Permitted investment in a covered fund.

(a) Authority and limitations on permitted investments in covered funds. (1) Notwithstanding the prohibition contained in § 75.10(a), a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity or an affiliate thereof organizes and offers pursuant to § 75.11, for the purposes of:

(i) *Establishment.* Establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, subject to the limits contained in paragraphs (a)(2)(i) and (a)(2)(iii) of this section; or

(ii) *De minimis investment.* Making and retaining an investment in the covered fund subject to the limits contained in paragraphs (a)(2)(ii) and (a)(2)(iii) of this section.

(2) *Investment limits*—(i) *Seeding period.* With respect to an investment in any covered fund made or held pursuant to paragraph (a)(1)(i) of this section, the banking entity and its affiliates:

(A) Must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) Must, no later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section), conform its ownership interest in the covered fund to the limits in paragraph (a)(2)(ii) of this section;

(ii) *Per-fund limits.* (A) Except as provided in paragraph (a)(2)(ii)(B) of this section, an investment by a banking entity and its affiliates in any covered fund made or held pursuant to paragraph (a)(1)(ii) of this section may not exceed 3 percent of the total number or value of the outstanding ownership interests of the fund.

(B) An investment by a banking entity and its affiliates in a covered fund that is an issuing entity of asset-backed securities may not exceed 3 percent of the total fair market value of the ownership interests of the fund measured in accordance with paragraph (b)(3) of this section, unless a greater percentage is retained by the banking entity and its affiliates in compliance with the requirements of section 15G of the Exchange Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the amount, number, or value of ownership interests of the fund required under section 15G of the Exchange Act and the implementing regulations issued thereunder.

(iii) *Aggregate limit.* The aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired or retained under this section may not exceed 3 percent of the tier 1 capital of the banking entity, as provided under paragraph (c) of this section, and shall be calculated as of the last day of each calendar quarter.

(iv) *Date of establishment.* For purposes of this section, the date of establishment of a covered fund shall be:

(A) *In general.* The date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund;

(B) *Issuing entities of asset-backed securities.* In the case of an issuing entity of asset-backed securities, the date on which the assets are initially transferred into the issuing entity of asset-backed securities.

(b) *Rules of construction*—(1) *Attribution of ownership interests to a covered banking entity.* (i) For purposes of paragraph (a)(2) of this section, the amount and value of a banking entity's permitted investment in any single covered fund shall include any ownership interest held under § 75.12 directly by the banking entity, including any affiliate of the banking entity.

(ii) Treatment of registered investment companies, SEC-regulated business development companies and foreign public funds. For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies or foreign public fund as described in § 75.10(c)(1) will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

(iii) *Covered funds.* For purposes of paragraph (b)(1)(i) of this section, a covered fund will not be considered to be an affiliate of a banking entity so long as the covered fund is held in compliance with the requirements of this subpart.

(iv) Treatment of employee and director investments financed by the banking entity. For purposes of paragraph (b)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires an ownership interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(2) *Calculation of permitted ownership interests in a single covered fund.* Except as provided in paragraphs (b)(3) or (4) of this section, for purposes of determining whether an investment in a single covered fund complies with

the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (ii)(A) of this section:

(i) The aggregate number of the outstanding ownership interests held by the banking entity shall be the total number of ownership interests held under this section by the banking entity in a covered fund divided by the total number of ownership interests held by all entities in that covered fund, as of the last day of each calendar quarter (both measured without regard to committed funds not yet called for investment);

(ii) The aggregate value of the outstanding ownership interests held by the banking entity shall be the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity, divided by the value of all investments in and capital contributions made to that covered fund by all entities, as of the last day of each calendar quarter (all measured without regard to committed funds not yet called for investment). If fair market value cannot be determined, then the value shall be the historical cost basis of all investments in and contributions made by the banking entity to the covered fund;

(iii) For purposes of the calculation under paragraph (b)(2)(ii) of this section, once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards.

(3) *Issuing entities of asset-backed securities.* In the case of an ownership interest in an issuing entity of asset-backed securities, for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(B) of this section:

(i) For securitizations subject to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11), the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder; or

(ii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the calculations shall be made as of the date of establishment as defined in paragraph (a)(2)(iv)(B) of this section or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund, and thereafter only upon the date on which additional securities of the issuing entity of asset-backed securities are priced for purposes of the sales of ownership interests to unaffiliated investors.

(iii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

(iv) For purposes of the calculation under paragraph (b)(3)(iii) of this section, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards.

(4) *Multi-tier fund investments*—(i) *Master-feeder fund investments.* If the principal investment strategy of a covered fund (the ''feeder fund'') is to invest substantially all of its assets in another single covered fund (the ''master fund''), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest of the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments.* If a banking entity organizes and offers a covered fund pursuant to § 75.11 for the purpose of investing in other covered funds (a ''fund of funds'') and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest of the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(c) *Aggregate permitted investments in all covered funds.* (1) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 75.10(d)(6)(ii)), on a historical cost basis.

(2) *Calculation of tier 1 capital.* For purposes of paragraph (a)(2)(iii) of this section:

(i) *Entities that are required to hold and report tier 1 capital.* If a banking entity is required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be equal to the amount of tier 1 capital of the banking entity as of the last day of the most recent calendar quarter, as reported to its primary financial regulatory agency; and

(ii) If a banking entity is not required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, be equal to the amount of tier 1 capital reported by such controlling depository institution in the manner described in paragraph (c)(2)(i) of this section;

(B) In the case of a banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(1) *Bank holding company subsidiaries.* If the banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, be equal to the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital in the manner described in paragraph (c)(2)(i) of this section; and

(2) Other holding companies and any subsidiary or affiliate thereof. If the banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, be equal to the total amount of shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(iii) *Treatment of foreign banking entities*—(A) *Foreign banking entities.* Except as provided in paragraph (c)(2)(iii)(B) of this section, with respect to a banking entity that is not itself, and is not controlled directly or indirectly by, a banking entity that is located or organized under the laws of the United States or of any State, the tier 1 capital of the banking entity shall be the consolidated tier 1 capital of the entity as calculated under applicable home country standards.

(B) *U.S. affiliates of foreign banking entities.* With respect to a banking entity that is located or organized under the laws of the United States or of any State and is controlled by a foreign banking entity identified under paragraph (c)(2)(iii)(A) of this section, the banking entity's tier 1 capital shall be as calculated under paragraphs (c)(2)(i) or (ii) of this section.

(d) *Capital treatment for a permitted investment in a covered fund.* For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 75.10(d)(6)(ii)), on a historical cost basis, plus any earnings received; and

(2) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (3) of this section (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 75.10(d)(6)(ii)), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(e) *Extension of time to divest an ownership interest.* (1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(2) *Factors governing Board determinations.* In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;

(v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;

(vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;

(vii) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;

(viii) Market conditions; and

(ix) Any other factor that the Board believes appropriate.

(3) *Authority to impose restrictions on activities or investment during any extension period.* The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(4) *Consultation.* In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

§ 75.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 75.10(a) does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund.

(2) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks arising in connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) The compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to this paragraph and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) *Certain permitted covered fund activities and investments outside of the United States.* (1) The prohibition contained in § 75.10(a) does not apply to the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a banking entity only if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in the covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity or investment occurs solely outside of the United States.

(2) An activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (b)(1)(ii) of this section only if:

(i) The activity or investment is conducted in accordance with the requirements of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of one or more States and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is sold or has been sold pursuant to an offering that does not target residents of the United States.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State;

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and

(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this section, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States; however, a foreign bank of which that branch, agency, or subsidiary is a part is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 75.10(a) does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

§ 75.14 Limitations on relationships with a covered fund.

(a) Relationships with a covered fund. (1) Except as provided for in paragraph (a)(2) of this section, no 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 § 75.11, or that continues to hold an ownership interest in accordance with § 75.11(b), and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of § 75.11, § 75.12, or § 75.13; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate thereof) has taken an ownership interest, if:

(A) The banking entity is in compliance with each of the limitations set forth in § 75.11 with respect to a covered fund organized and offered by such banking entity (or an affiliate thereof);

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually to the Commission (with a duty to update the certification if the information in the certification materially changes) 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; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

(b) *Restrictions on transactions with covered funds.* A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § 75.11, or that continues to hold an ownership interest in accordance with § 75.11(b), shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1), as if such banking entity were a member bank and such covered fund were an affiliate thereof.

(c) *Restrictions on prime brokerage transactions.* A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1) as if the counterparty were an affiliate of the banking entity.

§ 75.15 Other limitations on permitted covered fund activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 75.11 through 75.13 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§ 75.16 Ownership of interests in and sponsorship of issuers of certain collateralized debt obligations backed by trust-preferred securities.

(a) The prohibition contained in § 75.10(a)(1) does not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer if:

(1) The issuer was established, and the interest was issued, before May 19, 2010;

(2) The banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral; and

(3) The banking entity acquired such interest on or before December 10, 2013 (or acquired such interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before December 10, 2013).

(b) For purposes of this § 75.16, *Qualifying TruPS Collateral* shall mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument, had total consolidated assets of less than $15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company.

(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 §§ 75.4 and 75.11.

(d) Without limiting the applicability of paragraph (a) of this section, the Board, the FDIC and the OCC will make public a non-exclusive list of issuers that meet the requirements of paragraph (a). A banking entity may rely on the list published by the Board, the FDIC and the OCC.

§§ 75.17–75.19 [Reserved]

Subpart D—Compliance Program Requirement; Violations

§ 75.20 Program for compliance; reporting.

(a) *Program requirement.* 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 this part. The terms, scope and detail of the compliance program shall be appropriate for the types, size, scope and complexity of activities and business structure of the banking entity.

(b) *Contents of compliance program.* Except as provided in paragraph (f) of this section, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities subject to subpart B of this part (including those permitted under §§ 75.3 to 75.6), including setting,

monitoring and managing required limits set out in §§ 75.4 and 75.5, and activities and investments with respect to a covered fund subject to subpart C of this part (including those permitted under §§ 75.11 through 75.14) conducted by the banking entity to ensure that all activities and investments conducted by the banking entity that are subject to section 13 of the BHC Act and this part comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and this part and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in this part or by management as requiring attention;

(4) Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a banking entity must promptly provide to the Commission upon request and retain for a period of no less than 5 years or such longer period as required by the Commission.

(c) *Additional standards.* In addition to the requirements in paragraph (b) of this section, the compliance program of a banking entity must satisfy the requirements and other standards contained in appendix B of this part, if:

(1) The banking entity engages in proprietary trading permitted under subpart B of this part and is required to comply with the reporting requirements of paragraph (d) of this section;

(2) The banking entity has reported total consolidated assets as of the previous calendar year end of $50 billion or more or, in the case of a foreign banking entity, has total U.S. assets as of the previous calendar year end of $50 billion or more (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States); or

(3) The Commission notifies the banking entity in writing that it must satisfy the requirements and other standards contained in appendix B of this part.

(d) *Reporting requirements under appendix A of this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B of this part shall comply with the reporting requirements described in appendix A of this part, if:

(i) The banking entity (other than a foreign banking entity as provided in paragraph (d)(1)(ii) of this section) has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section;

(ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section; or

(iii) The Commission notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A of this part.

(2) The threshold for reporting under paragraph (d)(1) of this section shall be $50 billion beginning on June 30, 2014; $25 billion beginning on April 30, 2016; and $10 billion beginning on December 31, 2016.

(3) *Frequency of reporting.* Unless the Commission notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with paragraph (d)(1) of this section) shall report the information required by appendix A of this part for each calendar month within 30 days of the end of the relevant calendar month; beginning with information for the month of January 2015, such information shall be reported within 10 days of the end of each calendar month. Any other banking entity subject to appendix A of this part shall report the information required by appendix A of this part for each calendar quarter within 30 days of the end of that calendar quarter unless the Commission notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* Any banking entity that has more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years shall maintain records that include:

(1) Documentation of the exclusions or exemptions other than sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund;

(2) For each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of covered fund provided by § 75.10(c)(1), (5), (8), (9), or (10), documentation supporting the banking entity's determination that the fund is not a covered fund pursuant to one or more of those exclusions;

(3) For each seeding vehicle described in § 75.10(c)(12)(i) or (iii) that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § 75.12(a)(2)(i)(B);

(4) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, if the aggregate amount of ownership interests in foreign public funds that are described in § 75.10(c)(1) owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or of any State) exceeds $50 million at the end of two or more consecutive calendar quarters,

beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar quarter, which documentation must continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters; and

(5) For purposes of paragraph (e)(4) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(f) *Simplified programs for less active banking entities*—(1) *Banking entities with no covered activities.* A banking entity that does not engage in activities or investments pursuant to subpart B or subpart C of this part (other than trading activities permitted pursuant to § 75.6(a)) may satisfy the requirements of this section by establishing the required compliance program prior to becoming engaged in such activities or making such investments (other than trading activities permitted pursuant to § 75.6(a)).

(2) *Banking entities with modest activities.* A banking entity with total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engages in activities or investments pursuant to subpart B or subpart C of this part (other than trading activities permitted under § 75.6(a)) may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope and complexity of the banking entity.

§ 75.21 Termination of activities or investments; penalties for violations.

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C of this part, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the Commission finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or this part, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or this part, the Commission may take any action permitted by law to enforce compliance with section 13 of the BHC Act and this part, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

Appendix A to Part 75—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B of this part (''proprietary trading restrictions''). Pursuant to § 75.20(d), this appendix generally applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the Commission regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 75.20 and Appendix B of this part.

b. The purpose of this appendix is to assist banking entities and the Commission in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 75.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to § 75.4, 75.5, or 75.6(a) and (b) (*i.e.,* underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the Commission of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. The quantitative measurements that must be furnished pursuant to this appendix are *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In order to allow banking entities and the Agencies to evaluate the effectiveness of these metrics, banking entities must collect and report these metrics for all trading desks beginning on the dates established in § 75.20. The Agencies will review the data collected and revise this collection requirement as appropriate based on a review of the data collected prior to September 30, 2015.

e. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 75.20 and Appendix B of this part. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

f. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 75.4 through 75.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the Commission, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 75.2 and 75.3. In addition, for purposes of this appendix, the following definitions apply:

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under § 75.4, 75.5, or 75.6(a) or (b). A banking entity may include trading under § 75.3(d) or 75.6(c), (d) or (e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading desk means 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.

III. Reporting and Recordkeeping of Quantitative Measurements

a. Scope of Required Reporting

General scope. Each banking entity made subject to this part by § 75.20 must furnish the following quantitative measurements for each trading desk of the banking entity, calculated in accordance with this appendix:

- Risk and Position Limits and Usage;
- Risk Factor Sensitivities;
- Value-at-Risk and Stress VaR;
- Comprehensive Profit and Loss Attribution;
- Inventory Turnover;
- Inventory Aging; and
- Customer Facing Trade Ratio

b. Frequency of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report each applicable quantitative measurement to the Commission on the reporting schedule established in § 75.20 unless otherwise requested by the Commission. All quantitative measurements for any calendar month must be reported within the time period required by § 75.20.

c. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the Commission pursuant to this appendix and § 75.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the Commission to verify the accuracy of such reports, for a period of 5 years from the end of the calendar year for which the measurement was taken.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the portion of the trading desk's limits that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited, to the limits set out in §§ 75.4 and 75.5. A number of the metrics that are described below, including ''Risk Factor Sensitivities'' and ''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 activities under § 75.4(b) and hedging activity under § 75.5. Accordingly, the limits required under §§ 75.4(b)(2)(iii) and 75.5(b)(1)(i) must meet the applicable requirements under §§ 75.4(b)(2)(iii) and 75.5(b)(1)(i) and also must include appropriate metrics for the trading desk limits including, at a minimum, the ''Risk Factor Sensitivities'' and ''Value-at-Risk and Stress Value-at-Risk'' metrics except to the extent any of the ''Risk Factor Sensitivities'' or ''Value-at-Risk and Stress Value-at-Risk'' metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

ii. *General Calculation Guidance:* Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached must be reported.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

2. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk.

ii. *General Calculation Guidance:* A banking entity must report the Risk Factor Sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. The underlying data and methods used to compute a trading desk's Risk Factor Sensitivities will depend on the specific function of the trading desk and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading desk, and furnished to the Commission, will depend on the explicit risks assumed by the trading desk. In general, however, reported Risk Factor Sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings.

A. Trading desks must take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:

- *Commodity derivative positions:* Risk factors with respect to the related commodities set out in § 20.2 of this chapter, the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Credit positions:* Risk factors with respect to credit spreads that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and risk factors with respect to interest rates of all relevant maturities;
- *Credit-related derivative positions:* Risk factor sensitivities, for example credit spreads, shifts (parallel and non-parallel) in credit spreads—volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity derivative positions:* Risk factor sensitivities such as equity positions, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity positions:* Risk factors for equity prices and risk factors that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;
- *Foreign exchange derivative positions:* Risk factors with respect to major currency pairs and maturities, exposure to interest rates at relevant maturities, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and
- *Interest rate positions, including interest rate derivative positions:* Risk factors with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and shifts (parallel and non-parallel) in the interest rate curve, as well as the maturity profile of the positions.

B. The methods used by a banking entity to calculate sensitivities to a common factor shared by multiple trading desks, such as an equity price factor, must be applied consistently across its trading desks so that the sensitivities can be compared from one trading desk to another.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Value-at-Risk and Stress Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the commonly used percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on current market conditions. For purposes of this appendix, Stress Value-at-Risk (''Stress VaR'') is the percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on market conditions during a period of significant financial stress.

ii. *General Calculation Guidance:* Banking entities must compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading desk that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR must be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions''); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (*i.e.,* the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific Risk Factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

C. The portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *General Calculation Guidance:* The specific categories used by a trading desk in the attribution analysis and amount of detail for the analysis should be tailored to the type and amount of trading activities undertaken by the trading desk. The new position attribution must be computed by calculating the difference between the prices at which instruments were bought and/or sold and the prices at which those instruments are marked to market at the close of business on that day multiplied by the notional or principal amount of each purchase or sale. Any fees, commissions, or other payments received (paid) that are associated with transactions executed on that day must be added (subtracted) from such difference. These factors must be measured consistently over time to facilitate historical comparisons.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

c. Customer-Facing Activity Measurements

1. Inventory Turnover

i. *Description:* For purposes of this appendix, Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period.

ii. *General Calculation Guidance:* For purposes of this appendix, for derivatives, other than options and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

2. Inventory Aging

i. *Description:* For purposes of this appendix, Inventory Aging generally describes a schedule of the trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held. Inventory Aging should measure the age profile of the trading desk's assets and liabilities.

ii. *General Calculation Guidance:* In general, Inventory Aging must be computed using a trading desk's trading activity data and must identify the value of a trading desk's aggregate assets and liabilities. Inventory Aging must include two schedules, an asset-aging schedule and a liability-aging schedule. Each schedule must record the value of assets or liabilities held over all holding periods. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value and, for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Customer-Facing Trade Ratio—Trade Count Based and Value Based

i. *Description:* For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A trade count based ratio must be computed that records the number of transactions involving a counterparty that is a customer of the trading desk and the number of transactions involving a counterparty that is not a customer of the trading desk. A value based ratio must be computed that records the value of transactions involving a counterparty that is a customer of the trading desk and the value of transactions involving a counterparty that is not a customer of the trading desk.

ii. *General Calculation Guidance:* For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 75.20(d)(1) unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

Appendix B to Part 75—Enhanced Minimum Standards for Compliance Programs

I. Overview

Section 75.20(c) requires certain banking entities to establish, maintain, and enforce an enhanced compliance program that includes the requirements and standards in this Appendix as well as the minimum written policies and procedures, internal controls, management framework, independent testing, training, and recordkeeping provisions outlined in § 75.20. This Appendix sets forth additional minimum standards with respect to the establishment, oversight, maintenance, and enforcement by these banking entities of an enhanced internal compliance program for ensuring and monitoring 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 this part.

a. This compliance program must:

1. Be reasonably designed to identify, document, monitor, and report the permitted trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these covered activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and this part;

2. Establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and this part;

3. Subject the effectiveness of the compliance program to periodic independent review and testing, and ensure that the entity's internal audit, corporate compliance and internal control functions involved in review and testing are effective and independent;

4. Make senior management, and others as appropriate, accountable for the effective implementation of the compliance program, and ensure that the board of directors and chief executive officer (or equivalent) of the banking entity review the effectiveness of the compliance program; and

5. Facilitate supervision and examination by the Agencies of the banking entity's permitted trading and covered fund activities and investments.

II. Enhanced Compliance Program

a. Proprietary Trading Activities

A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, and complexity of, and risks associated with, its permitted trading activities. The compliance program may be tailored to the types of trading activities conducted by the banking entity, and must include a detailed description of controls established by the banking entity to reasonably ensure that its trading activities are conducted in accordance with the requirements and limitations applicable to those trading activities under section 13 of the BHC Act and this part, and provide for appropriate revision of the compliance program before expansion of the trading activities of the banking entity. A banking entity must devote adequate resources and use knowledgeable personnel in conducting, supervising and managing its trading activities, and promote consistency, independence and rigor in implementing its risk controls and compliance efforts. The compliance program must be updated with a frequency sufficient to account for changes in the activities of the banking entity, results of independent testing of the program, identification of weaknesses in the program, and changes in legal, regulatory or other requirements.

1. *Trading Desks:* The banking entity must have written policies and procedures governing each trading desk that include a description of:

i. The process for identifying, authorizing and documenting financial instruments each trading desk may purchase or sell, with separate documentation for market making-related activities conducted in reliance on § 75.4(b) and for hedging activity conducted in reliance on § 75.5;

ii. A mapping for each trading desk to the division, business line, or other organizational structure that is responsible for managing and overseeing the trading desk's activities;

iii. The mission (*i.e.,* the type of trading activity, such as market-making, trading in sovereign debt, etc.) and strategy (*i.e.,* methods for conducting authorized trading activities) of each trading desk;

iv. The activities that the trading desk is authorized to conduct, including (i) authorized instruments and products, and (ii) authorized hedging strategies, techniques and instruments;

v. The types and amount of risks allocated by the banking entity to each trading desk to implement the mission and strategy of the trading desk, including an enumeration of material risks resulting from the activities in which the trading desk is authorized to engage (including but not limited to price risks, such as basis, volatility and correlation risks, as well as counterparty credit risk). Risk assessments must take into account both the risks inherent in the trading activity and the strength and effectiveness of controls designed to mitigate those risks;

vi. How the risks allocated to each trading desk will be measured;

vii. Why the allocated risks levels are appropriate to the activities authorized for the trading desk;

viii. The limits on the holding period of, and the risk associated with, financial instruments under the responsibility of the trading desk;

ix. The process for setting new or revised limits, as well as escalation procedures for granting exceptions to any limits or to any policies or procedures governing the desk, the analysis that will be required to support revising limits or granting exceptions, and the process for independently reviewing and documenting those exceptions and the underlying analysis;

x. The process for identifying, documenting and approving new products, trading strategies, and hedging strategies;

xi. The types of clients, customers, and counterparties with whom the trading desk may trade; and

xii. The compensation arrangements, including incentive arrangements, for employees associated with the trading desk, which may not be designed to reward or incentivize prohibited proprietary trading or excessive or imprudent risk-taking.

2. *Description of risks and risk management processes:* The compliance program for the banking entity must include a comprehensive description of the risk management program for the trading activity of the banking entity. The compliance program must also include a description of the governance, approval, reporting, escalation, review and other processes the banking entity will use to reasonably ensure that trading activity is conducted in compliance with section 13 of the BHC Act and this part. Trading activity in similar financial instruments should be subject to similar governance, limits, testing, controls, and review, unless the banking entity specifically determines to establish different limits or processes and documents those differences. Descriptions must include, at a minimum, the following elements:

i. A description of the supervisory and risk management structure governing all trading activity, including a description of processes for initial and senior-level review of new products and new strategies;

ii. A description of the process for developing, documenting, testing, approving and reviewing all models used for valuing, identifying and monitoring the risks of trading activity and related positions, including the process for periodic independent testing of the reliability and accuracy of those models;

iii. A description of the process for developing, documenting, testing, approving and reviewing the limits established for each trading desk;

iv. A description of the process by which a security may be purchased or sold pursuant to the liquidity management plan, including the process for authorizing and monitoring such activity to ensure compliance with the banking entity's liquidity management plan and the restrictions on liquidity management activities in this part;

v. A description of the management review process, including escalation procedures, for approving any temporary exceptions or permanent adjustments to limits on the activities, positions, strategies, or risks associated with each trading desk; and

vi. The role of the audit, compliance, risk management and other relevant units for conducting independent testing of trading and hedging activities, techniques and strategies.

3. *Authorized risks, instruments, and products.* The banking entity must implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that trading activity is conducted in conformance with section 13 of the BHC Act and this part and with the banking entity's written policies and procedures. The banking entity must establish and enforce risk limits appropriate for the activity of each trading desk. These limits should be based on probabilistic and non-probabilistic measures of potential loss (*e.g.,* Value-at-Risk and notional exposure, respectively), and measured under normal and stress market conditions. At a minimum, these internal controls must monitor, establish and enforce limits on:

i. The financial instruments (including, at a minimum, by type and exposure) that the trading desk may trade;

ii. The types and levels of risks that may be taken by each trading desk; and

iii. The types of hedging instruments used, hedging strategies employed, and the amount of risk effectively hedged.

4. *Hedging policies and procedures.* The banking entity must establish, maintain, and enforce written policies and procedures regarding the use of risk-mitigating hedging instruments and strategies that, at a minimum, describe:

i. The positions, techniques and strategies that each trading desk may use to hedge the risk of its positions;

ii. The manner in which the banking entity will identify the risks arising in connection with and related to the individual or aggregated positions, contracts or other holdings of the banking entity that are to be hedged and determine that those risks have been properly and effectively hedged;

iii. The level of the organization at which hedging activity and management will occur;

iv. The manner in which hedging strategies will be monitored and the personnel responsible for such monitoring;

v. The risk management processes used to control unhedged or residual risks; and

vi. The process for developing, documenting, testing, approving and reviewing all hedging positions, techniques and strategies permitted for each trading desk and for the banking entity in reliance on § 75.5.

5. *Analysis and quantitative measurements.* The banking entity must perform robust analysis and quantitative measurement of its trading activities that is reasonably designed to ensure that the trading activity of each trading desk is consistent with the banking entity's compliance program; monitor and assist in the identification of potential and actual prohibited proprietary trading activity; and prevent the occurrence of prohibited proprietary trading. Analysis and models used to determine, measure and limit risk must be rigorously tested and be reviewed by management responsible for trading activity to ensure that trading activities, limits, strategies, and hedging activities do not understate the risk and exposure to the banking entity or allow prohibited proprietary trading. This review should include periodic and independent back-testing and revision of activities, limits, strategies and hedging as appropriate to contain risk and ensure compliance. In addition to the quantitative measurements reported by any banking entity subject to Appendix A of this part, each banking entity must develop and implement, to the extent appropriate to facilitate compliance with this part, additional quantitative measurements specifically tailored to the particular risks, practices, and strategies of its trading desks. The banking entity's analysis and quantitative measurements must incorporate the quantitative measurements reported by the banking entity pursuant to Appendix A of this part (if applicable) and include, at a minimum, the following:

i. Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of quantitative measurements;

ii. Ongoing, timely monitoring and review of calculated quantitative measurements;

iii. The establishment of numerical thresholds and appropriate trading measures for each trading desk and heightened review of trading activity not consistent with those thresholds to ensure compliance with section 13 of the BHC Act and this part, including analysis of the measurement results or other information, appropriate escalation procedures, and documentation related to the review; and

iv. Immediate review and compliance investigation of the trading desk's activities, escalation to senior management with oversight responsibilities for the applicable trading desk, timely notification to the Commission, appropriate remedial action (*e.g.,* divesting of impermissible positions, cessation of impermissible activity, disciplinary actions), and documentation of the investigation findings and remedial action taken when quantitative measurements or other information, considered together with the facts and circumstances, or findings of internal audit, independent testing or other review suggest a reasonable likelihood that the trading desk has violated any part of section 13 of the BHC Act or this part.

6. *Other Compliance Matters.* In addition to the requirements specified above, the banking entity's compliance program must:

i. Identify activities of each trading desk that will be conducted in reliance on exemptions contained in §§ 75.4 through 75.6, including an explanation of:

A. How and where in the organization the activity occurs; and

B. Which exemption is being relied on and how the activity meets the specific requirements for reliance on the applicable exemption;

ii. Include an explanation of the process for documenting, approving and reviewing actions taken pursuant to the liquidity management plan, where in the organization this activity occurs, the securities permissible for liquidity management, the process for ensuring that liquidity management activities are not conducted for the purpose of prohibited proprietary trading, and the process for ensuring that securities purchased as part of the liquidity management plan are highly liquid and conform to the requirements of this part;

iii. Describe how the banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each trading desk that relies on the exemptions contained in §§ 75.3(d)(3) and 75.4 through 75.6, which must take into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in value cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that result in large and significant concentrations to sectors, risk factors, or counterparties;

iv. Establish responsibility for compliance with the reporting and recordkeeping requirements of subpart B of this part and § 75.20; and

v. Establish policies for monitoring and prohibiting potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties.

7. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any trading activity that may indicate potential violations of section 13 of the BHC Act and this part and to prevent actual violations of section 13 of the BHC Act and this part. The compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

b. Covered Fund Activities or Investments

A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, complexity and risks of the covered fund and related activities conducted and investments made, by the banking entity.

1. *Identification of covered funds.* The banking entity's compliance program must provide a process, which must include appropriate management review and independent testing, for identifying and documenting covered funds that each unit within the banking entity's organization sponsors or organizes and offers, and covered funds in which each such unit invests. In addition to the documentation requirements for covered funds, as specified under § 75.20(e), the documentation must include information that identifies all pools that the banking entity sponsors or has an interest in and the type of exemption from the Commodity Exchange Act (whether or not the pool relies on § 4.7 of the regulations under the Commodity Exchange Act (§ 4.7 of this chapter)), and the amount of ownership interest the banking entity has in those pools.

2. *Identification of covered fund activities and investments.* The banking entity's compliance program must identify, document and map each unit within the organization that is permitted to acquire or hold an interest in any covered fund or sponsor any covered fund and map each unit to the division, business line, or other organizational structure that will be responsible for managing and overseeing that unit's activities and investments.

3. *Explanation of compliance.* The banking entity's compliance program must explain how:

i. The banking entity monitors for and prohibits potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties related to its covered fund activities and investments;

ii. The banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the banking entity related to its covered fund activities and investments; and

iii. The banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by its covered fund activities and investments, taking into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in values cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that expose the banking entity to large and significant concentrations with respect to sectors, risk factors, or counterparties;

4. *Description and documentation of covered fund activities and investments.* For each organizational unit engaged in covered fund activities and investments, the banking entity's compliance program must document:

i. The covered fund activities and investments that the unit is authorized to conduct;

ii. The banking entity's plan for actively seeking unaffiliated investors to ensure that any investment by the banking entity conforms to the limits contained in § 75.12 or registered in compliance with the securities laws and thereby exempt from those limits within the time periods allotted in § 75.12; and

iii. How it complies with the requirements of subpart C of this part.

5. *Internal Controls.* A banking entity must establish, maintain, and enforce internal controls that are reasonably designed to ensure that its covered fund activities or investments comply with the requirements of section 13 of the BHC Act and this part and are appropriate given the limits on risk established by the banking entity. These written internal controls must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part. The internal controls must, at a minimum require:

i. Monitoring and limiting the banking entity's individual and aggregate investments in covered funds;

ii. Monitoring the amount and timing of seed capital investments for compliance with the limitations under subpart C of this part (including but not limited to the redemption, sale or disposition requirements of § 75.12), and the effectiveness of efforts to seek unaffiliated investors to ensure compliance with those limits;

iii. Calculating the individual and aggregate levels of ownership interests in one or more covered fund required by § 75.12;

iv. Attributing the appropriate instruments to the individual and aggregate ownership interest calculations above;

v. Making disclosures to prospective and actual investors in any covered fund organized and offered or sponsored by the banking entity, as provided under § 75.11(a)(8);

vi. Monitoring for and preventing any relationship or transaction between the banking entity and a covered fund that is prohibited under § 75.14, including where the banking entity has been designated as the sponsor, investment manager, investment adviser, or commodity trading advisor to a covered fund by another banking entity; and

vii. Appropriate management review and supervision across legal entities of the banking entity to ensure that services and products provided by all affiliated entities comply with the limitation on services and products contained in § 75.14.

6. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part and to prevent actual violations of section 13 of the BHC Act and this part. The banking entity's compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, including § 75.21, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity or investment indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

III. Responsibility and Accountability for the Compliance Program

a. A banking entity must establish, maintain, and enforce a governance and management framework to manage its business and employees with a view to preventing violations of section 13 of the BHC Act and this part. A banking entity must have an appropriate management framework reasonably designed to ensure that: Appropriate personnel are responsible and accountable for the effective implementation and enforcement of the compliance program; a clear reporting line with a chain of responsibility is delineated; and the compliance program is reviewed periodically by senior management. The board of directors (or equivalent governance body) and senior management should have the appropriate authority and access to personnel and information within the organizations as well as appropriate resources to conduct their oversight activities effectively.

1. *Corporate governance.* The banking entity must adopt a written compliance program approved by the board of directors, an appropriate committee of the board, or equivalent governance body, and senior management.

2. *Management procedures.* The banking entity must establish, maintain, and enforce a governance framework that is reasonably designed to achieve compliance with section 13 of the BHC Act and this part, which, at a minimum, provides for:

i. The designation of appropriate senior management or committee of senior management with authority to carry out the management responsibilities of the banking entity for each trading desk and for each organizational unit engaged in covered fund activities;

ii. Written procedures addressing the management of the activities of the banking entity that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, including:

A. A description of the management system, including the titles, qualifications, and locations of managers and the specific responsibilities of each person with respect to the banking entity's activities governed by section 13 of the BHC Act and this part; and

B. Procedures for determining compensation arrangements for traders engaged in underwriting or market making-related activities under § 75.4 or risk-mitigating hedging activities under § 75.5 so that such compensation arrangements are designed not to reward or incentivize prohibited proprietary trading and appropriately balance risk and financial results in a manner that does not encourage employees to expose the banking entity to excessive or imprudent risk.

3. *Business line managers.* Managers with responsibility for one or more trading desks of the banking entity are accountable for the effective implementation and enforcement of the compliance program with respect to the applicable trading desk(s).

4. *Board of directors, or similar corporate body, and senior management*. The board of

directors, or similar corporate body, and senior management are responsible for setting and communicating an appropriate culture of compliance with section 13 of the BHC Act and this part and ensuring that appropriate policies regarding the management of trading activities and covered fund activities or investments are adopted to comply with section 13 of the BHC Act and this part. The board of directors or similar corporate body (such as a designated committee of the board or an equivalent governance body) must ensure that senior management is fully capable, qualified, and properly motivated to manage compliance with this part in light of the organization's business activities and the expectations of the board of directors. The board of directors or similar corporate body must also ensure that senior management has established appropriate incentives and adequate resources to support compliance with this part, including the implementation of a compliance program meeting the requirements of this appendix into management goals and compensation structures across the banking entity.

5. *Senior management.* Senior management is responsible for implementing and enforcing the approved compliance program. Senior management must also ensure that effective corrective action is taken when failures in compliance with section 13 of the BHC Act and this part are identified. Senior management and control personnel charged with overseeing compliance with section 13 of the BHC Act and this part should review the compliance program for the banking entity periodically and report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading activities and covered fund activities or investments, which shall be at least annually.

6. *CEO attestation.* Based on a review by the CEO of the banking entity, the CEO of the banking entity must, annually, attest in writing to the Commission that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under this appendix and § 75.20 in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the United States operations of the foreign banking entity who is located in the United States.

IV. Independent Testing

a. Independent testing must occur with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading and covered fund activities or investments, which shall be at least annually. This independent testing must include an evaluation of:

1. The overall adequacy and effectiveness of the banking entity's compliance program, including an analysis of the extent to which the program contains all the required elements of this appendix;

2. The effectiveness of the banking entity's internal controls, including an analysis and documentation of instances in which such internal controls have been breached, and how such breaches were addressed and resolved; and

3. The effectiveness of the banking entity's management procedures.

b. A banking entity must ensure that independent testing regarding the effectiveness of the banking entity's compliance program is conducted by a qualified independent party, such as the banking entity's internal audit department, compliance personnel or risk managers independent of the organizational unit being tested, outside auditors, consultants, or other qualified independent parties. A banking entity must promptly take appropriate action to remedy any significant deficiencies or material weaknesses in its compliance program and to terminate any violations of section 13 of the BHC Act or this part.

V. Training

Banking entities must provide adequate training to personnel and managers of the banking entity engaged in activities or investments governed by section 13 of the BHC Act or this part, as well as other appropriate supervisory, risk, independent testing, and audit personnel, in order to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the banking entity's trading activities and covered fund activities or investments.

VI. Recordkeeping

Banking entities must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A banking entity must retain these records for a period that is no less than 5 years or such longer period as required by the Commission in a form that allows it to promptly produce such records to the Commission on request.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Chapter II

Authority and Issuance

For the reasons set forth in the Common Preamble, the Securities and Exchange Commission amends part 255 to chapter II of Title 17 of the Code of Federal Regulations as follows:

PART 255—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 60. The authority citation for part 255 continues to read as follows:

Authority: 12 U.S.C. 1851.

Subpart A—Authority and Definitions

■ 61. Section 255.2 is revised to read as follows:

§ 255.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraph (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraph (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in § 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Limited trading assets and liabilities* means with respect to a banking entity that:

(1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 255.6(a)(1) and (2) of subpart B) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion; and

(ii) The SEC has not determined pursuant to § 255.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (s)(3) of this section, trading assets and liabilities for purposes of this paragraph (s) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 255.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (s) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 255.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States).

(ii) For purposes of paragraph (s)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (s)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States, including branches outside the United States that are managed or controlled by a U.S. branch or agency of the foreign banking organization, for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(t) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(u) *Moderate trading assets and liabilities* means, with respect to a banking entity, that the banking entity does not have significant trading assets and liabilities or limited trading assets and liabilities.

(v) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(w) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(x) *Qualifying foreign banking organization* means a foreign banking organization that qualifies as such under § 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(y) *SEC* means the Securities and Exchange Commission.

(z) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(aa) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(bb) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(cc) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(dd) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(ee) *Significant trading assets and liabilities* means with respect to a banking entity that: (1)(i) The banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $20 billion; or

(ii) The SEC has determined pursuant to § 255.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity, other than a banking entity described in paragraph (ee)(3) of this section, trading assets and liabilities for purposes of this paragraph (ee) means trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 255.6(a)(1) and (2) of subpart B) on a worldwide consolidated basis.

(3)(i) With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, trading assets and liabilities for purposes of this paragraph (ee) means the trading assets and liabilities (excluding trading assets and liabilities attributable to trading activities permitted pursuant to § 255.6(a)(1) and (2) of subpart B) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States as well as branches outside the United States that are managed or controlled by a branch or agency of the foreign banking entity operating, located or organized in the United States).

(ii) For purposes of paragraph (ee)(3)(i) of this section, a U.S. branch, agency, or subsidiary of a banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary. For purposes of paragraph (ee)(3)(i) of this section, all foreign operations of a U.S. agency, branch, or subsidiary of a foreign banking organization are considered to be located in the United States for purposes of calculating the banking entity's U.S. trading assets and liabilities.

(ff) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(gg) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(hh) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ii) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

■ 62. Section 255.3 is amended by:
■ a. Revising paragraphs (b) and (d)(3), (8), and (9);
■ b. Adding paragraphs (d)(10) through (13);
■ c. Redesignating paragraphs (e)(5) through (13) as paragraphs (e)(6) through (14);
■ d. Adding new paragraph (e)(5); and
■ e. Revising paragraph (e)(11), (12), and (14).

The revisions and additions read as follows:

§ 255.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account.* (1) *Trading account.* Trading account means:

(i) Any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging one or more of the positions resulting from the purchases or sales of financial instruments described in this paragraph;

(ii) Any account that is used by a banking entity to purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, 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; or

(iii) Any account that is used by a banking entity to purchase or sell one or more financial instruments, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Trading account application for certain banking entities.* (i) A banking entity that is subject to paragraph (b)(1)(ii) of this section in determining the scope of its trading account is not subject to paragraph (b)(1)(i) of this section.

(ii) A banking entity that does not calculate risk-based capital ratios under the market risk capital rule and is not a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk based capital ratios under the market risk capital rule may elect to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph. A banking entity that elects under this section to apply paragraph (b)(1)(ii) of this section in determining the scope of its trading account as if it were subject to that paragraph is not required to apply paragraph (b)(1)(i) of this section.

(3) *Consistency of account election for certain banking entities.* (i) Any election or change to an election under paragraph (b)(2)(ii) of this section must apply to the electing banking entity and all of its wholly owned subsidiaries. The primary financial regulatory agency of a banking entity that is affiliated with but is not a wholly owned subsidiary of such electing banking entity may require that the banking entity be subject to this uniform application requirement if the primary financial regulatory agency determines that it is necessary to prevent evasion of the requirements of this part after notice and opportunity for response as provided in subpart D.

(ii) A banking entity that does not elect under paragraph (b)(2)(ii) of this section to be subject to the trading account definition in (b)(1)(ii) may continue to apply the trading account definition in paragraph (b)(1)(i) of this section for one year from the date on which it becomes, or becomes a consolidated affiliate for regulatory reporting purposes with, a banking entity that calculates risk-based capital ratios under the market risk capital rule.

(4) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed not to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for sixty days or longer and does not transfer substantially all of the risk of the financial instrument within sixty days of the purchase (or sale).

* * * * *

(d) * * *

(3) Any purchase or sale of a security, foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)), or cross-currency swap by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular financial instruments to be used for liquidity management purposes, the amount, types, and risks of these financial instruments that are consistent with liquidity management, and the liquidity circumstances in which the particular financial instruments may or must be used;

(ii) Requires that any purchase or sale of financial instruments contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any financial instruments purchased or sold for liquidity management purposes be highly liquid and limited to financial instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any financial instruments purchased or sold for liquidity management purposes, together with any other financial instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under § 255.6(a) or (b) of this subpartare for the purpose of liquidity management and in accordance with the liquidity management plan described in this paragraph (d)(3); and

(vi) Is consistent with the SEC's regulatory requirements regarding liquidity management;

* * * * *

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity;

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the SEC;

(10) Any purchase or sale of one or more financial instruments that was made in error by a banking entity in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error;

(11) Contemporaneously entering into a customer-driven swap or customer-driven security-based swap and a matched swap or security-based swap if:

(i) The banking entity retains no more than minimal price risk; and

(ii) The banking entity is not a registered dealer, swap dealer, or security-based swap dealer;

(12) Any purchase or sale of one or more financial instruments that the banking entity uses to hedge mortgage servicing rights or mortgage servicing assets in accordance with a documented hedging strategy; or

(13) Any purchase or sale of a financial instrument that does not meet the definition of trading asset or trading liability under the applicable reporting form for a banking entity as of January 1, 2020.

(e) * * *

(5) *Cross-currency swap* means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

* * * * *

(11) *Market risk capital rule covered position and trading position* means a financial instrument that meets the criteria to be a covered position and a trading position, as those terms are respectively defined, without regard to whether the financial instrument is reported as a covered position or trading position on any applicable regulatory reporting forms:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(12) *Market risk capital rule* means the market risk capital rule that is contained in 12 CFR part 3, subpart F, with respect to a banking entity for which the OCC is the primary financial regulatory agency, 12 CFR part 217 with respect to a banking entity for which the Board is the primary financial regulatory agency, or 12 CFR part 324 with respect to a banking entity for which the FDIC is the primary financial regulatory agency.

* * * * *

(14) *Trading desk* means a 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 that is:

(i)(A) Structured by the banking entity to implement a well-defined business strategy;

(B) Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, and strategies; and

(C) Characterized by a clearly defined unit that:

(*1*) Engages in coordinated trading activity with a unified approach to its key elements;

(*2*) Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;

(*3*) Submits compliance reports and other information as a unit for monitoring by management; and

(*4*) Books its trades together; or

(ii) For a banking entity that calculates risk-based capital ratios under the market risk capital rule, or a consolidated affiliate for regulatory reporting purposes of a banking entity that calculates risk-based capital ratios under the market risk capital rule, established by the banking entity or its affiliate for purposes of market risk capital calculations under the market risk capital rule.

■ 63. Section 255.4 is revised to read as follows:

§ 255.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 255.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii)(A) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities; and

(B) Reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant types of securities;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, in accordance with paragraph (a)(2)(ii)(A) of this section;

(C) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (a)(2)(iii)(B) and (C) of this section by complying with the requirements set forth below in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a distribution of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this section, *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 255.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure, routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure, and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The trading desk's market-making related activities are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(iii) In the case of a banking entity with significant trading assets and liabilities, the banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and positions; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, in accordance with paragraph (b)(2)(ii) of this section;

(D) Written authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval; and

(E) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits.

(iv) A banking entity with significant trading assets and liabilities may satisfy the requirements in paragraphs (b)(2)(iii)(C) and (D) of this section by complying with the requirements set forth below in paragraph (c) of this section;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with the methodology described in § 255.2(ee) of this part, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(ii) [Reserved]

(4) *Definition of financial exposure.* For purposes of this section, *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) *Definition of market-maker positions.* For the purposes of this section, *market-maker positions* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

(c) *Rebuttable presumption of compliance*—(1) *Internal limits.* (i) A banking entity shall be presumed to meet the requirement in paragraph (a)(2)(ii)(A) or (b)(2)(ii) of this section with respect to the purchase or sale of a financial instrument if the banking entity has established and implements, maintains, and enforces the internal limits for the relevant trading desk as described in paragraph (c)(1)(ii) of this section.

(ii)(A) With respect to underwriting activities conducted pursuant to paragraph (a) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of securities and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's underwriting activities, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held.

(B) With respect to market making-related activities conducted pursuant to paragraph (b) of this section, the presumption described in paragraph (c)(1)(i) of this section shall be available to each trading desk that establishes, implements, maintains, and enforces internal limits that should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, based on the nature and amount of the trading desk's market-making related activities, that address the:

(*1*) Amount, types, and risks of its market-maker positions;

(*2*) Amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) Level of exposures to relevant risk factors arising from its financial exposure; and

(4) Period of time a financial instrument may be held.

(2) *Supervisory review and oversight.* The limits described in paragraph (c)(1) of this section shall be subject to supervisory review and oversight by the SEC on an ongoing basis.

(3) *Limit breaches and increases.* (i) With respect to any limit set pursuant to paragraphs (c)(1)(ii)(A) or (c)(1)(ii)(B) of this section, a banking entity shall maintain and make available to the SEC upon request records regarding any limit that is exceeded and any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the SEC.

(ii) In the event of a breach or increase of any limit set pursuant to paragraph (c)(1)(ii)(A) or (B) of this section, the presumption described in paragraph (c)(1)(i) of this section shall continue to be available only if the banking entity:

(A) Takes action as promptly as possible after a breach to bring the trading desk into compliance; and

(B) Follows established written authorization procedures, including escalation procedures that require review and approval of any trade that exceeds a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval.

(4) *Rebutting the presumption.* The presumption in paragraph (c)(1)(i) of this section may be rebutted by the SEC if the SEC determines, taking into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments and based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The SEC's rebuttal of the presumption in paragraph (c)(1)(i) must be made in accordance with the notice and response procedures in subpart D of this part.

■ 64. Section 255.5 is amended by revising paragraphs (b) and (c)(1) introductory text and adding paragraph (c)(4) to read as follows:

§ 255.5 Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements.* (1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * *

(1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

■ 65. Section 255.6 is amended by revising paragraph (e)(3); removing paragraphs (e)(4) and (6); and redesignating paragraph (e)(5) as paragraph (e)(4).

The revision reads as follows:

§ 255.6 Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including relevant personnel) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

Subpart C—Covered Funds Activities and Investments

■ 66. Section 255.10 is amended by revising paragraphs (c)(7)(ii) and (c)(8)(i)(A) to read as follows:

§ 255.10 Prohibition on Acquiring or Retaining an Ownership Interest in and Having Certain Relationships with a Covered Fund.

* * * * *

(c) * * *

(7) * * *

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable requirements regarding bank owned life insurance.

(8) * * *

(i) * * *

(A) Loans as defined in § 255.2(t) of subpart A;

* * * * *

■ 67. Section 255.11 is amended by revising paragraph (c) to read as follows:

§ 255.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 255.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 255.4(a) or § 255.4(b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78*o*–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 255.12(a)(2)(ii); § 255.12(a)(2)(iii), and § 255.12(d) of this subpart.

§ 255.12 [Amended]

■ 68. Section 255.12 is amended by redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

■ 69. Section 255.13 is amended by revising paragraphs (a), (b)(3) and (4), and (c) to read as follows:

§ 255.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 255.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program in accordance with subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks arising:

(*1*) Out of a transaction conducted solely to accommodate a specific customer request with respect to the covered fund; or

(*2*) In connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) With respect to risk-mitigating hedging activity conducted pursuant to paragraph (a)(1)(i) of this section, the compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to paragraph (a)(1)(i) and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) * * *

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States in which the banking entity or any affiliate of the banking entity participates. If the banking entity or an affiliate sponsors or serves, directly or indirectly, as the investment manager, investment adviser, commodity pool operator or commodity trading advisor to a covered fund, then the banking entity or affiliate will be deemed for purposes of this paragraph (b)(3) to participate in any offer or sale by the covered fund of ownership interests in the covered fund.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State; and

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

* * * * *

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 255.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws and regulations of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law or regulation described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

■ 70. Section 255.14 is amended by revising paragraph (a)(2)(ii)(B) to read as follows:

§ 255.14 Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the SEC (with a duty to update the certification if the information in the certification materially changes) 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; and

* * * * *

Subpart D—Compliance Program Requirement; Violations

■ 71. Section 255.20 is amended by eevising paragraphs (a), (b) introductory text, (c), (d), (e) introductory text, and (f)(2) and adding paragraphs (g), (h) and (i) to read as follows:

§ 255.20 Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) 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 this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) Banking entities with significant trading assets and liabilities. With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation.* The CEO of a banking entity that has significant trading assets and liabilities must, based on a review by the CEO of the banking entity, attest in writing to the SEC, each year no later than March 31, that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program required by paragraph (b) of this section in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the U.S. operations of the foreign banking entity who is located in the United States.

(d) Reporting requirements under appendix A to this part. (1) A banking entity engaged in proprietary trading activity permitted under subpart B of this part shall comply with the reporting requirements described in appendix A to this part, if:

(i) The banking entity has significant trading assets and liabilities; or

(ii) The SEC notifies the banking entity in writing that it must satisfy the reporting requirements contained in appendix A to this part.

(2) Frequency of reporting: Unless the SEC notifies the banking entity in writing that it must report on a different basis, a banking entity subject to appendix A to this part shall report the information required by appendix A for each quarter within 30 days of the end of the quarter.

(e) Additional documentation for covered funds. A banking entity with

significant trading assets and liabilities shall maintain records that include:

* * * * *

(f) * * *

(2) *Banking entities with moderate trading assets and liabilities.* A banking entity with moderate trading assets and liabilities may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity.

(g) Rebuttable presumption of compliance for banking entities with limited trading assets and liabilities—(1) *Rebuttable presumption.* Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities shall be presumed to be compliant with subpart B and subpart C of this part and shall have no obligation to demonstrate compliance with this part on an ongoing basis.

(2) *Rebuttal of presumption.* If upon examination or audit, the SEC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C of this part, the SEC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities. The SEC's rebuttal of the presumption in this paragraph must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the SEC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the SEC determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C of this part, does not warrant a presumption of compliance under paragraph (g) of this section or treatment as a banking entity with moderate trading assets and liabilities, as applicable. The SEC's exercise of this reservation of authority must be made in accordance with the notice and response procedures in paragraph (i) of this section.

(i) *Notice and response procedures*—(1) *Notice.* The SEC will notify the banking entity in writing of any determination requiring notice under this part and will provide an explanation of the determination.

(2) *Response.* The banking entity may respond to any or all items in the notice described in paragraph (i)(1) of this section. The response should include any matters that the banking entity would have the SEC consider in deciding whether to make the determination. The response must be in writing and delivered to the designated SEC official within 30 days after the date on which the banking entity received the notice. The SEC may shorten the time period when, in the opinion of the SEC, the activities or condition of the banking entity so requires, provided that the banking entity is informed of the time period at the time of notice, or with the consent of the banking entity. In its discretion, the SEC may extend the time period for good cause.

(3) *Waiver.* Failure to respond within 30 days or such other time period as may be specified by the SEC shall constitute a waiver of any objections to the SEC's determination.

(4) *Decision.* The SEC will notify the banking entity of the decision in writing. The notice will include an explanation of the decision.

■ 72. Revise appendix A to part 255 to read as follows:

Appendix A to Part 255—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 255.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the SEC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 255.20.

b. The purpose of this appendix is to assist banking entities and the SEC in:

(1) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(2) Monitoring the banking entity's covered trading activities;

(3) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(4) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 255.4(b) are consistent with the requirements governing permitted market making-related activities;

(5) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to § 255.4, § 255.5, or § 255.6(a) and (b) (*i.e.,* underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(6) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by SEC of such activities; and

(7) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is not intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 255.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 255.4 through 255.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to SEC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 255.2 and 255.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under § 255.4, § 255.5, § 255.6(a), or § 255.6(b). A banking entity may include in its covered trading activity trading conducted under § 255.3(d), § 255.6(c), § 255.6(d), or § 255.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. Quantitative measurements. Each banking entity made subject to this appendix by § 255.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Internal Limits and Usage;

ii. Value-at-Risk;

iii. Comprehensive Profit and Loss Attribution;

iv. Positions; and

v. Transaction Volumes.

2. Trading desk information. Each banking entity made subject to this appendix by § 255.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. Quantitative measurements identifying information. Each banking entity made subject to this appendix by § 255.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. Narrative statement. Each banking entity made subject to this appendix by § 255.20 may provide an optional narrative statement, as further described in this appendix.

5. File identifying information. Each banking entity made subject to this appendix by § 255.20 must provide file identifying information in each submission to the SEC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. Trading Desk Information

1. Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

i. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;

ii. Identification of each type of covered trading activity in which the trading desk is engaged;

iii. Brief description of the general strategy of the trading desk;

v. A list identifying each Agency receiving the submission of the trading desk;

2. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and

3. Currency reported and daily currency conversion rate.

c. Quantitative Measurements Identifying Information

Each banking entity must provide the following information regarding the quantitative measurements:

1. An Internal Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Internal Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, the unit of measurement for the limit, the type of limit, and identification of the corresponding risk factor attribution in the particular case that the limit type is a limit on a risk factor sensitivity and profit and loss attribution to the same risk factor is reported; and

2. A Risk Factor Attribution Information Schedule that provides identifying and descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement, including the name of the risk factor or other factor, a unique identification label for the risk factor or other factor, a description of the risk factor or other factor, and the risk factor or other factor's change unit.

d. Narrative Statement

Each banking entity made subject to this appendix by § 255.20 may submit in a separate electronic document a Narrative Statement to the SEC with any information the banking entity views as relevant for assessing the information reported. The Narrative Statement may include further description of or changes to calculation methods, identification of material events, description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such changes occurred.

e. Frequency and Method of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the SEC on the reporting schedule established in § 255.20 unless otherwise requested by the SEC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the SEC in accordance with the XML Schema specified and published on the SEC's website.

f. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the SEC pursuant to this appendix and § 255.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the SEC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the SEC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Internal Limits and Usage

i. *Description:* For purposes of this appendix, Internal Limits are 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. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Internal limits and their usage are key compliance and risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in §§ 255.4 and 255.5. A trading desk's risk limits, commonly including a limit on ''Value-at-Risk,'' are useful in the broader context of the trading desk's overall activities, particularly for the market making activities under § 255.4(b) and hedging activity under § 255.5. Accordingly, the limits required under §§ 255.4(b)(2)(iii)(C) and 255.5(b)(1)(i)(A) must meet the applicable requirements under §§ 255.4(b)(2)(iii)(C) and 255.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, ''Value-at-Risk'' except to the extent the ''Value-at-Risk'' metric is demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

A. A banking entity must provide the following information for each limit reported pursuant to this quantitative measurement: The unique identification label for the limit reported in the Internal Limits Information Schedule, the limit size (distinguishing between an upper and a lower limit), and the value of usage of the limit.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

2. Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the measurement of the risk of future financial loss in the value of a trading desk's aggregated positions at the ninety-nine percent confidence level over a one-day period, based on current market conditions.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into two categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); and (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions'').

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to (i) changes in the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. For the attribution of comprehensive profit and loss from existing positions to specific risk factors and other factors, a banking entity must provide the following information for the factors that explain the preponderance of the profit or loss changes due to risk factor changes: The unique identification label for the risk factor or other factor listed in the Risk Factor Attribution Information Schedule, and the profit or loss due to the risk factor or other factor change.

C. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

D. The portion of comprehensive profit and loss from existing positions that is not attributed to changes in specific risk factors and other factors must be allocated to a residual category. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks engaged in covered trading activities.

c. Positions and Transaction Volumes Measurements

1. Positions

i. *Description:* For purposes of this appendix, Positions is the value of securities and derivatives positions managed by the trading desk. For purposes of the Positions quantitative measurement, do not include in the Positions calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [1] A banking entity must separately report the trading desk's market value of long securities positions, short securities positions, derivatives receivables, and derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 255.4(a) or (b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description:* For purposes of this appendix, Transaction Volumes measures three exclusive categories of covered trading activity conducted by a trading desk. A banking entity is required to report the value and number of security and derivative transactions conducted by the trading desk with: (i) Customers, excluding internal transactions; (ii) non-customers, excluding internal transactions; and (iii) trading desks and other organizational units where the transaction is booked into either the same banking entity or an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for ''securities'' those securities that are also ''derivatives,'' as those terms are defined under subpart A; instead, report those securities that are also derivatives as ''derivatives.'' [2] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 255.4(a) to conduct underwriting activity is a market participant identified in § 255.4(a)(7), and a customer of a trading desk that relies on § 255.4(b) to conduct market making-related activity is a market participant identified in § 255.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability:* All trading desks that rely on § 255.4(a) or (b) to conduct underwriting activity or market-making-related activity, respectively.

Appendix B to Part 255 [Removed]

■ 73. Appendix B to part 255 is removed.

[1] *See* § 255.2(h), (aa). For example, under this part, a security-based swap is both a ''security'' and a ''derivative.'' For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.

[2] *See* § 255.2(h), (aa).

■ 74. Effective January 1, 2020, until December 31, 2020, appendix Z to part 255 is added to read as follows:

Appendix Z to Part 255—Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Alternative Compliance)

Note: The content of this appendix reproduces the regulation implementing Section 13 of the Bank Holding Company Act as of November 13, 2019.

Subpart A—Authority and Definitions

§ 255.1 Authority, purpose, scope, and relationship to other authorities.

(a) *Authority.* This part is issued by the SEC under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851).

(b) *Purpose.* Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds by certain banking entities, including registered broker-dealers, registered investment advisers, and registered security-based swap dealers, among others identified in section 2(12)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5301(12)(B)). This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and explaining the statute's requirements.

(c) *Scope.* This part implements section 13 of the Bank Holding Company Act with respect to banking entities for which the SEC is the primary financial regulatory agency, as defined in this part, but does not include such entities to the extent they are not within the definition of banking entity in § 255.2(c).

(d) *Relationship to other authorities.* Except as otherwise provided under section 13 of the Bank Holding Company Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of Bank Holding Company Act shall apply to the activities and investments of a banking entity identified in paragraph (c) of this section, even if such activities and investments are authorized for the banking entity under other applicable provisions of law.

(e) *Preservation of authority.* Nothing in this part limits in any way the authority of the SEC to impose on a banking entity identified in paragraph (c) of this section additional requirements or restrictions with respect to any activity, investment, or relationship covered under section 13 of the Bank Holding Company Act or this part, or additional penalties for violation of this part provided under any other applicable provision of law.

§ 255.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(c) *Banking entity.* (1) Except as provided in paragraph (c)(2) of this section, *banking entity* means:

(i) Any insured depository institution;

(ii) Any company that controls an insured depository institution;

(iii) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(iv) Any affiliate or subsidiary of any entity described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

(2) Banking entity does not include:

(i) A covered fund that is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section;

(ii) A portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act (12 U.S.C. 1843(k)(4)(H), (I)), or any portfolio concern, as defined under 13 CFR 107.50, that is controlled by a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), so long as the portfolio company or portfolio concern is not itself a banking entity under paragraphs (c)(1)(i), (ii), or (iii) of this section; or

(iii) The FDIC acting in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(d) *Board* means the Board of Governors of the Federal Reserve System.

(e) *CFTC* means the Commodity Futures Trading Commission.

(f) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(g) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(h) *Derivative.* (1) Except as provided in paragraph (h)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and the SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(i) *Employee* includes a member of the immediate family of the employee.

(j) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(k) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(l) *FDIC* means the Federal Deposit Insurance Corporation.

(m) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(n) *Foreign banking organization* has the same meaning as in section 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)), but does not include a foreign bank, as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7)), that is organized under the laws of the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, or the Commonwealth of the Northern Mariana Islands.

(o) *Foreign insurance regulator* means the insurance commissioner, or a similar official or agency, of any country other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(p) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(q) *Insurance company* means a company that is organized as an insurance company, primarily and predominantly engaged in writing insurance or reinsuring risks underwritten by insurance companies, subject to supervision as such by a state insurance regulator or a foreign insurance regulator, and not operated for the purpose of evading the provisions of section 13 of the BHC Act (12 U.S.C. 1851).

(r) *Insured depository institution,* unless otherwise indicated, has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include:

(1) An insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)); or

(2) An insured depository institution if it has, and if every company that controls it has, total consolidated assets of $10 billion or less and total trading assets and trading liabilities, on a consolidated basis, that are 5 percent or less of total consolidated assets.

(s) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(t) *Primary financial regulatory agency* has the same meaning as in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

(u) *Purchase* includes any contract to buy, purchase, or otherwise acquire. For security futures products, purchase includes any contract, agreement, or transaction for future delivery. With respect to a commodity future, purchase includes any contract, agreement, or transaction for future delivery. With respect to a derivative, purchase includes the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(v) *Qualifying foreign banking organization* means a foreign banking organization that qualifies as such under section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c), or (e)).

(w) *SEC* means the Securities and Exchange Commission.

(x) *Sale* and *sell* each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(y) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(z) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)).

(aa) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(bb) *Separate account* means an account established and maintained by an insurance company in connection with one or more insurance contracts to hold assets that are legally segregated from the insurance company's other assets, under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(cc) *State* means any State, the District of Columbia, the Commonwealth of Puerto Rico, Guam, American Samoa, the United States Virgin Islands, and the Commonwealth of the Northern Mariana Islands.

(dd) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ee) *State insurance regulator* means the insurance commissioner, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

(ff) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

Subpart B—Proprietary Trading

§ 255.3 Prohibition on proprietary trading.

(a) *Prohibition.* Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. *Proprietary trading* means engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

(b) *Definition of trading account.* (1) Trading account means any account that is used by a banking entity to:

(i) Purchase or sell one or more financial instruments principally for the purpose of:

(A) Short-term resale;

(B) Benefitting from actual or expected short-term price movements;

(C) Realizing short-term arbitrage profits; or

(D) Hedging one or more positions resulting from the purchases or sales of financial instruments described in paragraphs (b)(1)(i)(A), (B), or (C) of this section;

(ii) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(iii) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(A) Is licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such; or

(B) Is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the instrument is purchased or sold in connection with the activities of such business.

(2) *Rebuttable presumption for certain purchases and sales.* The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be for the trading account of the banking entity under paragraph (b)(1)(i) of this section if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale), unless the banking entity can demonstrate, based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section.

(c) *Financial instrument.* (1) *Financial instrument* means:

(i) A security, including an option on a security;

(ii) A derivative, including an option on a derivative; or

(iii) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(2) A financial instrument does not include:

(i) A loan;

(ii) A commodity that is not:

(A) An excluded commodity (other than foreign exchange or currency);

(B) A derivative;

(C) A contract of sale of a commodity for future delivery; or

(D) An option on a contract of sale of a commodity for future delivery; or

(iii) Foreign exchange or currency.

(d) *Proprietary trading.* Proprietary trading does not include:

(1) Any purchase or sale of one or more financial instruments by a banking entity that arises under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(2) Any purchase or sale of one or more financial instruments by a banking entity that arises under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(3) Any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan of the banking entity that:

(i) Specifically contemplates and authorizes the particular securities to be used for liquidity management purposes, the amount, types, and risks of these securities that are consistent with liquidity management, and the liquidity circumstances in which the particular securities may or must be used;

(ii) Requires that any purchase or sale of securities contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(iii) Requires that any securities purchased or sold for liquidity management purposes be highly liquid and limited to securities the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements;

(iv) Limits any securities purchased or sold for liquidity management purposes, together with any other instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of securities that are not permitted under §§ 255.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (d)(3) of this section; and

(vi) Is consistent with the SEC's supervisory requirements, guidance, and expectations regarding liquidity management;

(4) Any purchase or sale of one or more financial instruments by a banking entity that is a derivatives clearing organization or a clearing agency in connection with clearing financial instruments;

(5) Any excluded clearing activities by a banking entity that is a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(6) Any purchase or sale of one or more financial instruments by a banking entity, so long as:

(i) The purchase (or sale) satisfies an existing delivery obligation of the banking entity or its customers, including to prevent or close out a failure to deliver, in connection with delivery, clearing, or settlement activity; or

(ii) The purchase (or sale) satisfies an obligation of the banking entity in connection with a judicial, administrative, self-regulatory organization, or arbitration proceeding;

(7) Any purchase or sale of one or more financial instruments by a banking entity that is acting solely as agent, broker, or custodian;

(8) Any purchase or sale of one or more financial instruments by a banking entity through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity that is established and administered in accordance with the law of the United States or a foreign sovereign, if the purchase or sale is made directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity; or

(9) Any purchase or sale of one or more financial instruments by a banking entity in the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the financial instrument as soon as practicable, and in no event may the banking entity retain such instrument for longer than such period permitted by the SEC.

(e) *Definition of other terms related to proprietary trading.* For purposes of this subpart:

(1) *Anonymous* means that each party to a purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale.

(2) *Clearing agency* has the same meaning as in section 3(a)(23) of the Exchange Act (15 U.S.C. 78c(a)(23)).

(3) *Commodity* has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(4) *Contract of sale of a commodity for future delivery* means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27))).

(5) Derivatives clearing organization means:

(i) A derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1);

(ii) A derivatives clearing organization that, pursuant to CFTC regulation, is exempt from the registration requirements under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1); or

(iii) A foreign derivatives clearing organization that, pursuant to CFTC regulation, is permitted to clear for a foreign board of trade that is registered with the CFTC.

(6) *Exchange,* unless the context otherwise requires, means any designated contract market, swap execution facility, or foreign board of trade registered with the CFTC, or, for purposes of securities or security-based swaps, an exchange, as defined under section 3(a)(1) of the Exchange Act (15 U.S.C. 78c(a)(1)), or security-based swap execution facility, as defined under section 3(a)(77) of the Exchange Act (15 U.S.C. 78c(a)(77)).

(7) *Excluded clearing activities* means:

(i) With respect to customer transactions cleared on a derivatives clearing organization, a clearing agency, or a designated financial market utility, any purchase or sale necessary to correct trading errors made by or on behalf of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(ii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a customer provided that such purchase or sale is conducted in accordance with, for transactions cleared on a derivatives clearing organization, the Commodity Exchange Act, CFTC regulations, and the rules or procedures of the derivatives clearing organization, or, for transactions cleared on a clearing agency, the rules or procedures of the clearing agency, or, for transactions cleared on a designated financial market utility that is neither a derivatives clearing organization nor a clearing agency, the rules or procedures of the designated financial market utility;

(iii) Any purchase or sale in connection with and related to the management of a default or threatened imminent default of a member of a clearing agency, a member of a derivatives clearing organization, or a member of a designated financial market utility;

(iv) Any purchase or sale in connection with and related to the management of the default or threatened default of a clearing agency, a derivatives clearing organization, or a designated financial market utility; and

(v) Any purchase or sale that is required by the rules or procedures of a clearing agency, a derivatives clearing organization, or a designated financial market utility to mitigate the risk to the clearing agency, derivatives clearing organization, or designated financial market utility that would result from the clearing by a member of security-based swaps that reference the member or an affiliate of the member.

(8) *Designated financial market utility* has the same meaning as in section 803(4) of the Dodd-Frank Act (12 U.S.C. 5462(4)).

(9) *Issuer* has the same meaning as in section 2(a)(4) of the Securities Act of 1933 (15 U.S.C. 77b(a)(4)).

(10) *Market risk capital rule covered position and trading position* means a financial instrument that is both a covered position and a trading position, as those terms are respectively defined:

(i) In the case of a banking entity that is a bank holding company, savings and loan holding company, or insured depository institution, under the market risk capital rule that is applicable to the banking entity; and

(ii) In the case of a banking entity that is affiliated with a bank holding company or savings and loan holding company, other than a banking entity to which a market risk capital rule is applicable, under the market risk capital rule that is applicable to the affiliated bank holding company or savings and loan holding company.

(11) *Market risk capital rule* means the market risk capital rule that is contained in subpart F of 12 CFR part 3, 12 CFR parts 208 and 225, or 12 CFR part 324, as applicable.

(12) *Municipal security* means a security that is a direct obligation of or issued by, or an obligation guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States or political subdivisions thereof.

(13) *Trading desk* means 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.

§ 255.4 Permitted underwriting and market making-related activities.

(a) *Underwriting activities*—(1) *Permitted underwriting activities.* The prohibition contained in § 255.3(a) does not apply to a banking entity's underwriting activities conducted in accordance with this paragraph (a).

(2) *Requirements.* The underwriting activities of a banking entity are permitted under paragraph (a)(1) of this section only if:

(i) The banking entity is acting as an underwriter for a distribution of securities and the trading desk's underwriting position is related to such distribution;

(ii) The amount and type of the securities in the trading desk's underwriting position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (a) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The products, instruments or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;

(B) Limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including the reasonably expected near term demands of clients, customers, or counterparties, on the:

(*1*) Amount, types, and risk of its underwriting position;

(*2*) Level of exposures to relevant risk factors arising from its underwriting position; and

(*3*) Period of time a security may be held;

(C) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(D) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis of the basis for any temporary or permanent increase to a trading desk's limit(s), and independent review of such demonstrable analysis and approval;

(iv) The compensation arrangements of persons performing the activities described in this paragraph (a) are designed not to reward or incentivize prohibited proprietary trading; and

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

(3) *Definition of distribution.* For purposes of this paragraph (a), a *distribution* of securities means:

(i) An offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the presence of special selling efforts and selling methods; or

(ii) An offering of securities made pursuant to an effective registration statement under the Securities Act of 1933.

(4) *Definition of underwriter.* For purposes of this paragraph (a), *underwriter* means:

(i) A person who has agreed with an issuer or selling security holder to:

(A) Purchase securities from the issuer or selling security holder for distribution;

(B) Engage in a distribution of securities for or on behalf of the issuer or selling security holder; or

(C) Manage a distribution of securities for or on behalf of the issuer or selling security holder; or

(ii) A person who has agreed to participate or is participating in a distribution of such securities for or on behalf of the issuer or selling security holder.

(5) *Definition of selling security holder.* For purposes of this paragraph (a), *selling security holder* means any person, other than an issuer, on whose behalf a distribution is made.

(6) *Definition of underwriting position.* For purposes of this paragraph (a), *underwriting position* means the long or short positions in one or more securities held by a banking entity or its affiliate, and managed by a particular trading desk, in connection with a particular distribution of securities for which such banking entity or affiliate is acting as an underwriter.

(7) *Definition of client, customer, and counterparty.* For purposes of this paragraph (a), the terms *client, customer, and counterparty,* on a collective or individual basis, refer to market participants that may transact with the banking entity in connection with a particular distribution for which the banking entity is acting as underwriter.

(b) *Market making-related activities*—(1) *Permitted market making-related activities.* The prohibition contained in § 255.3(a) does not apply to a banking entity's market making-related activities conducted in accordance with this paragraph (b).

(2) *Requirements.* The market making-related activities of a banking entity are permitted under paragraph (b)(1) of this section only if:

(i) The trading desk that establishes and manages the financial exposure routinely stands ready to purchase and sell one or more types of financial instruments related to its financial exposure and is willing and available to quote, purchase and sell, or otherwise enter into long and short positions in those types of financial instruments for its own account, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the relevant types of financial instruments;

(ii) The amount, types, and risks of the financial instruments in the trading desk's market-maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on:

(A) The liquidity, maturity, and depth of the market for the relevant types of financial instrument(s); and

(B) Demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks, of or associated with financial instruments in which the trading desk makes a market, including through block trades;

(iii) The banking entity has established and implements, maintains, and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures, internal controls, analysis and independent testing identifying and addressing:

(A) The financial instruments each trading desk stands ready to purchase and sell in accordance with paragraph (b)(2)(i) of this section;

(B) The actions the trading desk will take to demonstrably reduce or otherwise significantly mitigate promptly the risks of its financial exposure consistent with the limits required under paragraph (b)(2)(iii)(C) of this section; the products, instruments, and exposures each trading desk may use for risk management purposes; the techniques and strategies each trading desk may use to manage the risks of its market making-related activities and inventory; and the process, strategies, and personnel responsible for ensuring that the actions taken by the trading desk to mitigate these risks are and continue to be effective;

(C) Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section, on:

(*1*) The amount, types, and risks of its market-maker inventory;

(*2*) The amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes;

(*3*) The level of exposures to relevant risk factors arising from its financial exposure; and

(*4*) The period of time a financial instrument may be held;

(D) Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and

(E) Authorization procedures, including escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s), demonstrable analysis that the basis for any temporary or permanent increase to a trading desk's limit(s) is consistent with the requirements of this paragraph (b), and independent review of such demonstrable analysis and approval;

(iv) To the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

(v) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) *Definition of client, customer, and counterparty.* For purposes of paragraph (b) of this section, the terms *client, customer, and counterparty,* on a collective or individual basis refer to market participants that make use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services, provided that:

(i) A trading desk or other organizational unit of another banking entity is not a client, customer, or counterparty of the trading desk if that other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 255.20(d)(1) of subpart D, unless:

(A) The trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk for purposes of paragraph (b)(2) of this section; or

(B) The purchase or sale by the trading desk is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants.

(4) *Definition of financial exposure.* For purposes of this paragraph (b), *financial exposure* means the aggregate risks of one or more financial instruments and any associated loans, commodities, or foreign exchange or currency, held by a banking entity or its affiliate and managed by a particular trading desk as part of the trading desk's market making-related activities.

(5) Definition of market-maker inventory. For the purposes of this paragraph (b), *market-maker inventory* means all of the positions in the financial instruments for which the trading desk stands ready to make a market in accordance with paragraph (b)(2)(i) of this section, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions.

§ 255.5 Permitted risk-mitigating hedging activities.

(a) *Permitted risk-mitigating hedging activities.* The prohibition contained in § 255.3(a) does not apply to the risk-mitigating hedging activities of a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity and designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

(b) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under paragraph (a) of this section only if:

(1) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(i) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(ii) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(iii) The conduct of analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged, and such correlation analysis demonstrates that the hedging activity demonstrably reduces or otherwise significantly mitigates the specific, identifiable risk(s) being hedged;

(2) The risk-mitigating hedging activity:

(i) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(ii) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(iii) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(iv) Is subject to continuing review, monitoring and management by the banking entity that:

(A) Is consistent with the written hedging policies and procedures required under paragraph (b)(1) of this section;

(B) Is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(C) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading; and

(3) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(c) *Documentation requirement*—(1) A banking entity must comply with the requirements of paragraphs (c)(2) and (3) of this section with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

(i) Not established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the hedging activity is designed to reduce;

(ii) Established by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings the risks of which the purchases or sales are designed to reduce, but that is effected through a financial instrument, exposure, technique, or strategy that is not specifically identified in the trading desk's written policies and procedures established under paragraph (b)(1) of this section or under § 255.4(b)(2)(iii)(B) of this subpart as a product, instrument, exposure, technique, or strategy such trading desk may use for hedging; or

(iii) Established to hedge aggregated positions across two or more trading desks.

(2) In connection with any purchase or sale identified in paragraph (c)(1) of this section, a banking entity must, at a minimum, and contemporaneously with the purchase or sale, document:

(i) The specific, identifiable risk(s) of the identified positions, contracts, or other holdings of the banking entity that the purchase or sale is designed to reduce;

(ii) The specific risk-mitigating strategy that the purchase or sale is designed to fulfill; and

(iii) The trading desk or other business unit that is establishing and responsible for the hedge.

(3) A banking entity must create and retain records sufficient to demonstrate compliance with the requirements of this paragraph (c) for a period that is no less than five years in a form that allows the banking entity to promptly produce such records to the SEC on request, or such longer period as required under other law or this part.

§ 255.6 Other permitted proprietary trading activities.

(a) *Permitted trading in domestic government obligations.* The prohibition contained in § 255.3(a) does not apply to the purchase or sale by a banking entity of a financial instrument that is:

(1) An obligation of, or issued or guaranteed by, the United States;

(2) An obligation, participation, or other instrument of, or issued or guaranteed by, an agency of the United States, the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*);

(3) An obligation of any State or any political subdivision thereof, including any municipal security; or

(4) An obligation of the FDIC, or any entity formed by or on behalf of the FDIC for purpose of facilitating the disposal of assets acquired or held by the FDIC in its corporate capacity or as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(b) *Permitted trading in foreign government obligations*—(1) *Affiliates of foreign banking entities in the United States.* The prohibition contained in § 255.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of such foreign sovereign, by a banking entity, so long as:

(i) The banking entity is organized under or is directly or indirectly controlled by a banking entity that is organized under the laws of a foreign sovereign and is not directly or indirectly controlled by a top-tier banking entity that is organized under the laws of the United States;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign banking entity referred to in paragraph (b)(1)(i) of this section is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The purchase or sale as principal is not made by an insured depository institution.

(2) *Foreign affiliates of a U.S. banking entity.* The prohibition contained in § 255.3(a) does not apply to the purchase or sale of a financial instrument that is an obligation of, or issued or guaranteed by, a foreign sovereign (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign, by a foreign entity that is

owned or controlled by a banking entity organized or established under the laws of the United States or any State, so long as:

(i) The foreign entity is a foreign bank, as defined in section 211.2(j) of the Board's Regulation K (12 CFR 211.2(j)), or is regulated by the foreign sovereign as a securities dealer;

(ii) The financial instrument is an obligation of, or issued or guaranteed by, the foreign sovereign under the laws of which the foreign entity is organized (including any multinational central bank of which the foreign sovereign is a member), or any agency or political subdivision of that foreign sovereign; and

(iii) The financial instrument is owned by the foreign entity and is not financed by an affiliate that is located in the United States or organized under the laws of the United States or of any State.

(c) *Permitted trading on behalf of customers*—(1) *Fiduciary transactions.* The prohibition contained in § 255.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as trustee or in a similar fiduciary capacity, so long as:

(i) The transaction is conducted for the account of, or on behalf of, a customer; and

(ii) The banking entity does not have or retain beneficial ownership of the financial instruments.

(2) *Riskless principal transactions.* The prohibition contained in § 255.3(a) does not apply to the purchase or sale of financial instruments by a banking entity acting as riskless principal in a transaction in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer.

(d) *Permitted trading by a regulated insurance company.* The prohibition contained in § 255.3(a) does not apply to the purchase or sale of financial instruments by a banking entity that is an insurance company or an affiliate of an insurance company if:

(1) The insurance company or its affiliate purchases or sells the financial instruments solely for:

(i) The general account of the insurance company; or

(ii) A separate account established by the insurance company;

(2) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (d)(2) of this section is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

(e) Permitted trading activities of foreign banking entities. (1) The prohibition contained in § 255.3(a) does not apply to the purchase or sale of financial instruments by a banking entity if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of any State;

(ii) The purchase or sale by the banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale meets the requirements of paragraph (e)(3) of this section.

(2) A purchase or sale of financial instruments by a banking entity is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (e)(1)(ii) of this section only if:

(i) The purchase or sale is conducted in accordance with the requirements of paragraph (e) of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of any State and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(*1*) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(*2*) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(*3*) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate or execute such purchase or sale) is not located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the United States or organized under the laws of the United States or of any State;

(iii) The purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State;

(iv) 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 the laws of the United States or of any State; and

(v) The purchase or sale is not conducted with or through any U.S. entity, other than:

(A) A purchase or sale with the foreign operations of a U.S. entity if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such purchase or sale;

(B) A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

(C) A purchase or sale through an unaffiliated market intermediary acting as agent, provided the purchase or sale is conducted anonymously on an exchange or similar trading facility and is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty.

(4) For purposes of this paragraph (e), a U.S. entity is any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this paragraph (e), a U.S. branch, agency, or subsidiary of

a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(6) For purposes of this paragraph (e), *unaffiliated market intermediary* means an unaffiliated entity, acting as an intermediary, that is:

(i) A broker or dealer registered with the SEC under section 15 of the Exchange Act or exempt from registration or excluded from regulation as such;

(ii) A swap dealer registered with the CFTC under section 4s of the Commodity Exchange Act or exempt from registration or excluded from regulation as such;

(iii) A security-based swap dealer registered with the SEC under section 15F of the Exchange Act or exempt from registration or excluded from regulation as such; or

(iv) A futures commission merchant registered with the CFTC under section 4f of the Commodity Exchange Act or exempt from registration or excluded from regulation as such.

§ 255.7 Limitations on permitted proprietary trading activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 255.4 through 255.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) *Definition of high-risk asset and high-risk trading strategy.* For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§§ 255.8–255.9 [Reserved]

Subpart C—Covered Funds Activities and Investments

§ 255.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) *Prohibition.* (1) Except as otherwise provided in this subpart, a banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(2) Paragraph (a)(1) of this section does not include acquiring or retaining an ownership interest in a covered fund by a banking entity:

(i) Acting solely as agent, broker, or custodian, so long as;

(A) The activity is conducted for the account of, or on behalf of, a customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest;

(ii) Through a deferred compensation, stock-bonus, profit-sharing, or pension plan of the banking entity (or an affiliate thereof) that is established and administered in accordance with the law of the United States or a foreign sovereign, if the ownership interest is held or controlled directly or indirectly by the banking entity as trustee for the benefit of persons who are or were employees of the banking entity (or an affiliate thereof);

(iii) In the ordinary course of collecting a debt previously contracted in good faith, provided that the banking entity divests the ownership interest as soon as practicable, and in no event may the banking entity retain such ownership interest for longer than such period permitted by the SEC; or

(iv) On behalf of customers as trustee or in a similar fiduciary capacity for a customer that is not a covered fund, so long as:

(A) The activity is conducted for the account of, or on behalf of, the customer; and

(B) The banking entity and its affiliates do not have or retain beneficial ownership of such ownership interest.

(b) *Definition of covered fund.* (1) Except as provided in paragraph (c) of this section, covered fund means:

(i) An issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), *but for* section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a–3(c)(1) or (7));

(ii) Any commodity pool under section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10)) for which:

(A) The commodity pool operator has claimed an exemption under 17 CFR 4.7; or

(B)(*1*) A commodity pool operator is registered with the CFTC as a commodity pool operator in connection with the operation of the commodity pool;

(*2*) Substantially all participation units of the commodity pool are owned by qualified eligible persons under 17 CFR 4.7(a)(2) and (3); and

(*3*) Participation units of the commodity pool have not been publicly offered to persons who are not qualified eligible persons under 17 CFR 4.7(a)(2) and (3); or

(iii) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, an entity that:

(A) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(B) Is, or holds 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; and

(C)(*1*) Has as its sponsor that banking entity (or an affiliate thereof); or

(*2*) Has issued an ownership interest that is owned directly or indirectly by that banking entity (or an affiliate thereof).

(2) An issuer shall not be deemed to be a covered fund under paragraph (b)(1)(iii) of this section if, were the issuer subject to U.S. securities laws, the issuer could rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act.

(3) For purposes of paragraph (b)(1)(iii) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(c) Notwithstanding paragraph (b) of this section, unless the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine otherwise, a covered fund does not include:

(1) *Foreign public funds.* (i) Subject to paragraphs (ii) and (iii) below, an issuer that:

(A) Is organized or established outside of the United States;

(B) Is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and

(C) Sells ownership interests predominantly through one or more public offerings outside of the United States.

(ii) With respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor, the sponsoring banking entity may not rely on the exemption in paragraph (c)(1)(i) of this section for such issuer unless ownership interests in the issuer are sold predominantly to persons other than:

(A) Such sponsoring banking entity;

(B) Such issuer;

(C) Affiliates of such sponsoring banking entity or such issuer; and

(D) Directors and employees of such entities.

(iii) For purposes of paragraph (c)(1)(i)(C) of this section, the term ''public offering'' means a distribution (as defined in § 255.4(a)(3) of subpart B) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that:

(A) The distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made;

(B) The distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and

(C) The issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.

(2) *Wholly-owned subsidiaries.* An entity, all of the outstanding ownership interests of which are owned directly or indirectly by the banking entity (or an affiliate thereof), except that:

(i) Up to five percent of the entity's outstanding ownership interests, less any amounts outstanding under paragraph (c)(2)(ii) of this section, may be held by employees or directors of the banking entity or such affiliate (including former employees or directors if their ownership interest was acquired while employed by or in the service of the banking entity); and

(ii) Up to 0.5 percent of the entity's outstanding ownership interests may be held by a third party if the ownership interest is acquired or retained by the third party for the purpose of establishing corporate separateness or addressing bankruptcy, insolvency, or similar concerns.

(3) *Joint ventures.* A joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons, provided that the joint venture:

(i) Is comprised of no more than 10 unaffiliated co-venturers;

(ii) 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

(iii) 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.

(4) *Acquisition vehicles.* An issuer:

(i) Formed solely for the purpose of engaging in a *bona fide* merger or acquisition transaction; and

(ii) That exists only for such period as necessary to effectuate the transaction.

(5) *Foreign pension or retirement funds.* A plan, fund, or program providing pension, retirement, or similar benefits that is:

(i) Organized and administered outside the United States;

(ii) A broad-based plan for employees or citizens that is subject to regulation as a pension, retirement, or similar plan under the laws of the jurisdiction in which the plan, fund, or program is organized and administered; and

(iii) Established for the benefit of citizens or residents of one or more foreign sovereigns or any political subdivision thereof.

(6) *Insurance company separate accounts.* A separate account, provided that no banking entity other than the insurance company participates in the account's profits and losses.

(7) *Bank owned life insurance.* A separate account that is used solely for the purpose of allowing one or more banking entities to purchase a life insurance policy for which the banking entity or entities is beneficiary, provided that no banking entity that purchases the policy:

(i) Controls the investment decisions regarding the underlying assets or holdings of the separate account; or

(ii) Participates in the profits and losses of the separate account other than in compliance with applicable supervisory guidance regarding bank owned life insurance.

(8) *Loan securitizations.* (i) *Scope.* An issuing entity for asset-backed securities that satisfies all the conditions of this paragraph (c)(8) and the assets or holdings of which are comprised solely of:

(A) Loans as defined in § 255.2(s) of subpart A;

(B) 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 paragraph (c)(8)(iii) of this section;

(C) Interest rate or foreign exchange derivatives that meet the requirements of paragraph (c)(8)(iv) of this section; and

(D) Special units of beneficial interest and collateral certificates that meet the requirements of paragraph (c)(8)(v) of this section.

(ii) *Impermissible assets.* For purposes of this paragraph (c)(8), the assets or holdings of the issuing entity shall not include any of the following:

(A) A security, including an asset-backed security, or an interest in an equity or debt security other than as permitted in paragraph (c)(8)(iii) of this section;

(B) A derivative, other than a derivative that meets the requirements of paragraph (c)(8)(iv) of this section; or

(C) A commodity forward contract.

(iii) *Permitted securities.* Notwithstanding paragraph (c)(8)(ii)(A) of this section, the issuing entity may hold securities if those securities are:

(A) Cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of this section; or

(B) Securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities.

(iv) *Derivatives.* The holdings of derivatives by the issuing entity shall be limited to interest rate or foreign exchange derivatives that satisfy all of the following conditions:

(A) The written terms of the derivative directly relate to the loans, the asset-backed securities, or the contractual rights of other assets described in paragraph (c)(8)(i)(B) of this section; and

(B) The derivatives reduce the interest rate and/or foreign exchange risks related to the loans, the asset-backed securities, or the contractual rights or other assets described in paragraph (c)(8)(i)(B) of this section.

(v) *Special units of beneficial interest and collateral certificates.* The assets or holdings of the issuing entity may include collateral certificates and special units of beneficial interest issued by a special purpose vehicle, provided that:

(A) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate meets the requirements in this paragraph (c)(8);

(B) The special unit of beneficial interest or collateral certificate is used for the sole purpose of transferring to the issuing entity for the loan securitization the economic risks and benefits of the assets that are permissible for loan securitizations under this paragraph (c)(8) and does not directly or indirectly transfer any interest in any other economic or financial exposure;

(C) The special unit of beneficial interest or collateral certificate is created solely to satisfy legal requirements or otherwise facilitate the structuring of the loan securitization; and

(D) The special purpose vehicle that issues the special unit of beneficial interest or collateral certificate and the issuing entity are established under the direction of the same entity that initiated the loan securitization.

(9) *Qualifying asset-backed commercial paper conduits.* (i) An issuing entity for asset-backed commercial paper that satisfies all of the following requirements:

(A) The asset-backed commercial paper conduit holds only:

(*1*) Loans and other assets permissible for a loan securitization under paragraph (c)(8)(i) of this section; and

(*2*) Asset-backed securities supported solely by assets that are permissible for loan securitizations under paragraph (c)(8)(i) of this section and acquired by the asset-backed commercial paper conduit as part of an initial issuance either directly from the issuing entity of the asset-backed securities or directly from an underwriter in the distribution of the asset-backed securities;

(B) The asset-backed commercial paper conduit issues only asset-backed securities, comprised of a residual interest and securities with a legal maturity of 397 days or less; and

(C) A regulated liquidity provider has entered into a legally binding commitment to provide full and unconditional liquidity coverage with respect to all of the outstanding asset-backed securities issued by the asset-backed commercial paper conduit (other than any residual interest) in the event that funds are required to redeem maturing asset-backed securities.

(ii) For purposes of this paragraph (c)(9), a regulated liquidity provider means:

(A) A depository institution, as defined in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(B) A bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a subsidiary thereof;

(C) A savings and loan holding company, as defined in section 10a of the Home Owners' Loan Act (12 U.S.C. 1467a), provided all or substantially all of the holding company's activities are permissible for a financial holding company under section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), or a subsidiary thereof;

(D) A foreign bank whose home country supervisor, as defined in § 211.21(q) of the Board's Regulation K (12 CFR 211.21(q)), has adopted capital standards consistent with the Capital Accord for the Basel Committee on banking Supervision, as amended, and that is subject to such standards, or a subsidiary thereof; or

(E) The United States or a foreign sovereign.

(10) *Qualifying covered bonds*—(i) *Scope.* An entity owning or holding a dynamic or fixed pool of loans or other assets as provided in paragraph (c)(8) of this section for the benefit of the holders of covered bonds, provided that the assets in the pool are comprised solely of assets that meet the conditions in paragraph (c)(8)(i) of this section.

(ii) *Covered bond.* For purposes of this paragraph (c)(10), a covered bond means:

(A) A debt obligation issued by an entity that meets the definition of foreign banking organization, the payment obligations of which are fully and unconditionally guaranteed by an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section; or

(B) A debt obligation of an entity that meets the conditions set forth in paragraph (c)(10)(i) of this section, provided that the payment obligations are fully and unconditionally guaranteed by an entity that meets the definition of foreign banking organization and the entity is a wholly-owned subsidiary, as defined in paragraph (c)(2) of this section, of such foreign banking organization.

(11) SBICs and public welfare investment funds. An issuer:

(i) That is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958 (15 U.S.C. 662), or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked; or

(ii) The business of which is to make investments that are:

(A) Designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(B) Qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(12) *Registered investment companies and excluded entities.* An issuer:

(i) 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 as described in § 255.20(e)(3) of subpart D and that complies with the requirements of section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a–18);

(ii) That may rely on an exclusion or exemption from the definition of ''investment company'' under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) other than the exclusions contained in section 3(c)(1) and 3(c)(7) of that Act; or

(iii) That has elected to be regulated as a business development company 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 business development company as described in § 255.20(e)(3) of subpart D and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a–60).

(13) *Issuers in conjunction with the FDIC's receivership or conservatorship operations.* An issuer that is an entity formed by or on behalf of the FDIC for the purpose of facilitating the disposal of assets acquired in the FDIC's capacity as conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(14) *Other excluded issuers.* (i) Any issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act.

(ii) A determination made under paragraph (c)(14)(i) of this section will be promptly made public.

(d) *Definition of other terms related to covered funds.* For purposes of this subpart:

(1) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the SEC determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(2) *Asset-backed security* has the meaning specified in Section 3(a)(79) of the Exchange Act (15 U.S.C. 78c(a)(79)).

(3) *Director* has the same meaning as provided in section 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

(4) *Issuer* has the same meaning as in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(22)).

(5) *Issuing entity* means with respect to asset-backed securities the special purpose vehicle that owns or holds the pool assets underlying asset-backed securities and in whose name the asset-backed securities supported or serviced by the pool assets are issued.

(6) *Ownership interest*—(i) *Ownership interest* means any equity, partnership, or other similar interest. An ''other similar interest'' means an interest that:

(A) Has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(B) Has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund;

(C) Has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event);

(D) Has the right to receive all or a portion of excess spread (the positive difference, if any, between the aggregate interest payments received from the underlying assets of the covered fund and the aggregate interest paid to the holders of other outstanding interests);

(E) Provides under the terms of the interest that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund, such as allocation of losses, write-downs or charge-offs of the outstanding principal balance, or reductions in the amount of interest due and payable on the interest;

(F) Receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or

(G) Any synthetic right to have, receive, or be allocated any of the rights in paragraphs (d)(6)(i)(A) through (F) of this section.

(ii) *Ownership interest* does not include: *Restricted profit interest.* An interest held by an entity (or an employee or former employee thereof) in a covered fund for which the entity (or employee thereof) serves as investment manager, investment adviser, commodity trading advisor, or other service provider so long as:

(A) The sole purpose and effect of the interest is to allow the entity (or employee or former employee thereof) to share in the profits of the covered fund as performance compensation for the investment management, investment advisory, commodity trading advisory, or other services provided to the covered fund by the entity (or employee or former employee thereof), provided that the entity (or employee or former employee thereof) may be obligated under the terms of such interest to return profits previously received;

(B) All such profit, once allocated, is distributed to the entity (or employee or former employee thereof) promptly after being earned or, if not so distributed, is retained by the covered fund for the sole purpose of establishing a reserve amount to satisfy contractual obligations with respect to subsequent losses of the covered fund and such undistributed profit of the entity (or employee or former employee thereof) does not share in the subsequent investment gains of the covered fund;

(C) Any amounts invested in the covered fund, including any amounts paid by the entity (or employee or former employee thereof) in connection with obtaining the restricted profit interest, are within the limits of § 255.12 of this subpart; and

(D) The interest is not transferable by the entity (or employee or former employee thereof) except to an affiliate thereof (or an employee of the banking entity or affiliate), to immediate family members, or through the intestacy, of the employee or former employee, or in connection with a sale of the business that gave rise to the restricted profit interest by the entity (or employee or former employee thereof) to an unaffiliated party that provides investment management, investment advisory, commodity trading advisory, or other services to the fund.

(7) *Prime brokerage transaction* means 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.

(8) *Resident of the United States* means a person that is a ''U.S. person'' as defined in rule 902(k) of the SEC's Regulation S (17 CFR 230.902(k)).

(9) *Sponsor* means, with respect to a covered fund:

(i) To serve as a general partner, managing member, or trustee of a covered fund, or to serve as a commodity pool operator with respect to a covered fund as defined in (b)(1)(ii) of this section;

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name, except as permitted under § 255.11(a)(6).

(10) *Trustee.* (i) For purposes of paragraph (d)(9) of this section and § 255.11 of subpart C, a trustee does not include:

(A) A trustee that does not exercise investment discretion with respect to a covered fund, including a trustee that is subject to the direction of an unaffiliated named fiduciary who is not a trustee pursuant to section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)); or

(B) A trustee that is subject to fiduciary standards imposed under foreign law that are substantially equivalent to those described in paragraph (d)(10)(i)(A) of this section;

(ii) Any entity that directs a person described in paragraph (d)(10)(i) of this section, or that possesses authority and discretion to manage and control the investment decisions of a covered fund for which such person serves as trustee, shall be considered to be a trustee of such covered fund.

§ 255.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

(a) *Organizing and offering a covered fund in general.* Notwithstanding § 255.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund in connection with, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, only if:

(1) The banking entity (or an affiliate thereof) provides *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services;

(2) The covered fund is organized and offered only in connection with the provision of *bona fide* trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity (or an affiliate thereof), pursuant to a written plan or similar documentation outlining how the banking entity or such affiliate intends to provide advisory or similar services to its customers through organizing and offering such fund;

(3) The banking entity and its affiliates do not acquire or retain an ownership interest in the covered fund except as permitted under § 255.12 of this subpart;

(4) The banking entity and its affiliates comply with the requirements of § 255.14 of this subpart;

(5) The banking entity and its affiliates do 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;

(6) The covered fund, for corporate, marketing, promotional, or other purposes:

(i) Does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof) except that a covered fund may share the same name or a variation of the same name with a banking entity that is an investment adviser to the covered fund if:

(A) The investment adviser is not an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(B) The investment adviser does not share the same name or a variation of the same name as an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(ii) Does not use the word ''bank'' in its name;

(7) No director or employee of the banking entity (or an affiliate thereof) takes or retains an ownership interest in the covered fund, except for any director or employee of the banking entity or such affiliate who is directly engaged in providing investment advisory, commodity trading advisory, or other services to the covered fund at the time the director or employee takes the ownership interest; and

(8) The banking entity:

(i) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(A) That ''any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity] or its affiliates; therefore, [the banking entity's] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity] and any affiliate in its capacity as investor in the [covered fund] or as beneficiary of a restricted profit interest held by [the banking entity] or any affiliate'';

(B) That such investor should read the fund offering documents before investing in the covered fund;

(C) That the ''ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity'' (unless that happens to be the case); and

(D) The role of the banking entity and its affiliates and employees in sponsoring or providing any services to the covered fund; and

(ii) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates.

(b) *Organizing and offering an issuing entity of asset-backed securities.* (1) Notwithstanding § 255.10(a) of this subpart, a banking entity is not prohibited from acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund that is an issuing entity of asset-backed securities in connection with, directly or indirectly, organizing and offering that issuing entity, so long as the banking entity and its affiliates comply with all of the requirements of paragraph (a)(3) through (8) of this section.

(2) For purposes of this paragraph (b), organizing and offering a covered fund that is an issuing entity of asset-backed securities means acting as the securitizer, as that term is used in section 15G(a)(3) of the Exchange Act

(15 U.S.C. 78*o*–11(a)(3)) of the issuing entity, or acquiring or retaining an ownership interest in the issuing entity as required by section 15G of that Act (15 U.S.C.78*o*–11) and the implementing regulations issued thereunder.

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 255.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 255.4(a) or § 255.4(b) of subpart B, respectively;

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78o–11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78o–11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section; or, directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 255.12(a)(2)(ii) and § 255.12(d) of this subpart; and

(3) With respect to any banking entity, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under § 255.11 of this subpart, including all covered funds in which the banking entity holds an ownership interest in connection with underwriting and market making related activities permitted under this paragraph (c), are included in the calculation of all ownership interests under § 255.12(a)(2)(iii) and § 255.12(d) of this subpart.

§ 255.12 Permitted investment in a covered fund.

(a) *Authority and limitations on permitted investments in covered funds.* (1) Notwithstanding the prohibition contained in § 255.10(a) of this subpart, a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity or an affiliate thereof organizes and offers pursuant to § 255.11, for the purposes of:

(i) *Establishment.* Establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, subject to the limits contained in paragraphs (a)(2)(i) and (iii) of this section; or

(ii) *De minimis investment.* Making and retaining an investment in the covered fund subject to the limits contained in paragraphs (a)(2)(ii) and (iii) of this section.

(2) *Investment limits*—(i) *Seeding period.* With respect to an investment in any covered fund made or held pursuant to paragraph (a)(1)(i) of this section, the banking entity and its affiliates:

(A) Must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) Must, no later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section), conform its ownership interest in the covered fund to the limits in paragraph (a)(2)(ii) of this section;

(ii) *Per-fund limits.* (A) Except as provided in paragraph (a)(2)(ii)(B) of this section, an investment by a banking entity and its affiliates in any covered fund made or held pursuant to paragraph (a)(1)(ii) of this section may not exceed 3 percent of the total number or value of the outstanding ownership interests of the fund.

(B) An investment by a banking entity and its affiliates in a covered fund that is an issuing entity of asset-backed securities may not exceed 3 percent of the total fair market value of the ownership interests of the fund measured in accordance with paragraph (b)(3) of this section, unless a greater percentage is retained by the banking entity and its affiliates in compliance with the requirements of section 15G of the Exchange Act (15 U.S.C. 78*o*–11) and the implementing regulations issued thereunder, in which case the investment by the banking entity and its affiliates in the covered fund may not exceed the amount, number, or value of ownership interests of the fund required under section 15G of the Exchange Act and the implementing regulations issued thereunder.

(iii) *Aggregate limit.* The aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired or retained under this section may not exceed 3 percent of the tier 1 capital of the banking entity, as provided under paragraph (c) of this section, and shall be calculated as of the last day of each calendar quarter.

(iv) *Date of establishment.* For purposes of this section, the date of establishment of a covered fund shall be:

(A) *In general.* The date on which the investment adviser or similar entity to the covered fund begins making investments pursuant to the written investment strategy for the fund;

(B) *Issuing entities of asset-backed securities.* In the case of an issuing entity of asset-backed securities, the date on which the assets are initially transferred into the issuing entity of asset-backed securities.

(b) *Rules of construction*—(1) *Attribution of ownership interests to a covered banking entity.* (i) For purposes of paragraph (a)(2) of this section, the amount and value of a banking entity's permitted investment in any single covered fund shall include any ownership interest held under § 255▮▮.12 directly by the banking entity, including any affiliate of the banking entity.

(ii) *Treatment of registered investment companies, SEC-regulated business development companies and foreign public funds.* For purposes of paragraph (b)(1)(i) of this section, a registered investment company, SEC-regulated business development companies or foreign public fund as described in § 255▮▮.10(c)(1) of this subpart will not be considered to be an affiliate of the banking entity so long as the banking entity:

(A) Does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the company or fund; and

(B) Provides investment advisory, commodity trading advisory, administrative, and other services to the company or fund in compliance with the limitations under applicable regulation, order, or other authority.

(iii) *Covered funds.* For purposes of paragraph (b)(1)(i) of this section, a covered fund will not be considered to be an affiliate of a banking entity so long as the covered fund is held in compliance with the requirements of this subpart.

(iv) *Treatment of employee and director investments financed by the banking entity.* For purposes of paragraph (b)(1)(i) of this section, an investment by a director or employee of a banking entity who acquires an ownership interest in his or her personal capacity in a covered fund sponsored by the banking entity will be attributed to the banking entity if the banking entity, directly or indirectly, extends financing for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the financing is used to acquire such ownership interest in the covered fund.

(2) Calculation of permitted ownership interests in a single covered fund. Except as provided in paragraph (b)(3) or (4), for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(A) of this section:

(i) The aggregate number of the outstanding ownership interests held by the banking entity shall be the total number of ownership interests held under this section by the banking entity in a covered fund divided by the total number of ownership interests held by all entities in that covered fund, as of the last day of each calendar quarter (both measured without regard to committed funds not yet called for investment);

(ii) The aggregate value of the outstanding ownership interests held by the banking entity shall be the aggregate fair market value of all investments in and capital contributions made to the covered fund by the banking entity, divided by the value of all investments in and capital contributions made to that covered fund by all entities, as of the last day of each calendar quarter (all measured without regard to committed funds not yet called for investment). If fair market value cannot be determined, then the value shall be the historical cost basis of all investments in and contributions made by the banking entity to the covered fund;

(iii) For purposes of the calculation under paragraph (b)(2)(ii) of this section, once a valuation methodology is chosen, the banking entity must calculate the value of its investment and the investments of all others in the covered fund in the same manner and according to the same standards.

(3) Issuing entities of asset-backed securities. In the case of an ownership interest in an issuing entity of asset-backed securities, for purposes of determining whether an investment in a single covered fund complies with the restrictions on ownership interests under paragraphs (a)(2)(i)(B) and (a)(2)(ii)(B) of this section:

(i) For securitizations subject to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11), the calculations shall be made as of the date and according to the valuation methodology applicable pursuant to the requirements of section 15G of the Exchange Act (15 U.S.C. 78o–11) and the implementing regulations issued thereunder; or

(ii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the calculations shall be made as of the date of establishment as defined in paragraph (a)(2)(iv)(B) of this section or such earlier date on which the transferred assets have been valued for purposes of transfer to the covered fund, and thereafter only upon the date on which additional securities of the issuing entity of asset-backed securities are priced for purposes of the sales of ownership interests to unaffiliated investors.

(iii) For securitization transactions completed prior to the compliance date of such implementing regulations (or as to which such implementing regulations do not apply), the aggregate value of the outstanding ownership interests in the covered fund shall be the fair market value of the assets transferred to the issuing entity of the securitization and any other assets otherwise held by the issuing entity at such time, determined in a manner that is consistent with its determination of the fair market value of those assets for financial statement purposes.

(iv) For purposes of the calculation under paragraph (b)(3)(iii) of this section, the valuation methodology used to calculate the fair market value of the ownership interests must be the same for both the ownership interests held by a banking entity and the ownership interests held by all others in the covered fund in the same manner and according to the same standards.

(4) *Multi-tier fund investments*—(i) *Master-feeder fund investments.* If the principal investment strategy of a covered fund (the ''feeder fund'') is to invest substantially all of its assets in another single covered fund (the ''master fund''), then for purposes of the investment limitations in paragraphs (a)(2)(i)(B) and (a)(2)(ii) of this section, the banking entity's permitted investment in such funds shall be measured only by reference to the value of the master fund. The banking entity's permitted investment in the master fund shall include any investment by the banking entity in the master fund, as well as the banking entity's pro-rata share of any ownership interest of the master fund that is held through the feeder fund; and

(ii) *Fund-of-funds investments.* If a banking entity organizes and offers a covered fund pursuant to § 255.11 of this subpart for the purpose of investing in other covered funds (a ''fund of funds'') and that fund of funds itself invests in another covered fund that the banking entity is permitted to own, then the banking entity's permitted investment in that other fund shall include any investment by the banking entity in that other fund, as well as the banking entity's pro-rata share of any ownership interest of the fund that is held through the fund of funds. The investment of the banking entity may not represent more than 3 percent of the amount or value of any single covered fund.

(c) Aggregate permitted investments in all covered funds. (1) For purposes of paragraph (a)(2)(iii) of this section, the aggregate value of all ownership interests held by a banking entity shall be the sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest in covered funds (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 255 [redacted] .10(d)(6)(ii) of this subpart), on a historical cost basis.

(2) *Calculation of tier 1 capital.* For purposes of paragraph (a)(2)(iii) of this section:

(i) *Entities that are required to hold and report tier 1 capital.* If a banking entity is required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be equal to the amount of tier 1 capital of the banking entity as of the last day of the most recent calendar quarter, as reported to its primary financial regulatory agency; and

(ii) If a banking entity is not required to calculate and report tier 1 capital, the banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, be equal to the amount of tier 1 capital reported by such controlling depository institution in the manner described in paragraph (c)(2)(i) of this section;

(B) In the case of a banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(1) *Bank holding company subsidiaries.* If the banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, be equal to the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital in the manner described in paragraph (c)(2)(i) of this section; and

(2) *Other holding companies and any subsidiary or affiliate thereof.* If the banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, be equal to the total amount of shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(iii) *Treatment of foreign banking entities*—(A) *Foreign banking entities.* Except as provided in paragraph (c)(2)(iii)(B) of this section, with respect to a banking entity that is not itself, and is not controlled directly or indirectly by, a banking entity that is located or organized under the laws of the United States or of any State, the tier 1 capital of the banking entity shall be the consolidated tier 1 capital of the entity as calculated under applicable home country standards.

(B) *U.S. affiliates of foreign banking entities.* With respect to a banking entity that is located or organized under the laws of the United States or of any State and is controlled by a foreign banking entity identified under paragraph (c)(2)(iii)(A) of this section, the banking entity's tier 1 capital shall be as calculated under paragraphs (c)(2)(i) or (ii) of this section.

(d) *Capital treatment for a permitted investment in a covered fund.* For purposes of calculating compliance with the applicable regulatory capital requirements, a banking entity shall deduct from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section) the greater of:

(1) The sum of all amounts paid or contributed by the banking entity in connection with acquiring or retaining an ownership interest (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 255.10(d)(6)(ii) of subpart C), on a historical cost basis, plus any earnings received; and

(2) The fair market value of the banking entity's ownership interests in the covered fund as determined under paragraph (b)(2)(ii) or (b)(3) of this section (together with any amounts paid by the entity (or employee thereof) in connection with obtaining a restricted profit interest under § 255.10(d)(6)(ii) of subpart C), if the banking entity accounts for the profits (or losses) of the fund investment in its financial statements.

(e) *Extension of time to divest an ownership interest.* (1) Upon application by a banking entity, the Board may extend the period under paragraph (a)(2)(i) of this section for up to 2 additional years if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2) of this section.

(2) *Factors governing Board determinations.* In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(ii) The contractual terms governing the banking entity's interest in the covered fund;

(iii) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(iv) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity and the financial stability of the United States;

(v) The cost to the banking entity of divesting or disposing of the investment within the applicable period;

(vi) Whether the investment or the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated parties, including clients, customers or counterparties to which it owes a duty;

(vi) The banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund;

(viii) Market conditions; and

(ix) Any other factor that the Board believes appropriate.

(3) *Authority to impose restrictions on activities or investment during any extension period.* The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act and this part.

(4) *Consultation.* In the case of a banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to acting on an application by the banking entity for an extension under paragraph (e)(1) of this section.

§ 255.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 255.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund.

(2) *Requirements.* The risk-mitigating hedging activities of a banking entity are permitted under this paragraph (a) only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures; and

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(ii) The acquisition or retention of the ownership interest:

(A) Is made in accordance with the written policies, procedures and internal controls required under this section;

(B) At the inception of the hedge, is designed to reduce or otherwise significantly mitigate and demonstrably reduces or otherwise significantly mitigates one or more specific, identifiable risks arising in connection with the compensation arrangement with the employee that directly provides investment advisory, commodity trading advisory, or other services to the covered fund;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section; and

(D) Is subject to continuing review, monitoring and management by the banking entity.

(iii) The compensation arrangement relates solely to the covered fund in which the banking entity or any affiliate has acquired an ownership interest pursuant to this paragraph and such compensation arrangement provides that any losses incurred by the banking entity on such ownership interest will be offset by corresponding decreases in amounts payable under such compensation arrangement.

(b) Certain permitted covered fund activities and investments outside of the United States. (1) The prohibition contained in § 255.10(a) of this subpart does not apply to the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a banking entity only if:

(i) The banking entity is not organized or directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in the covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity or investment occurs solely outside of the United States.

(2) An activity or investment by the banking entity is pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act for purposes of paragraph (b)(1)(ii) of this section only if:

(i) The activity or investment is conducted in accordance with the requirements of this section; and

(ii)(A) With respect to a banking entity that is a foreign banking organization, the banking entity meets the qualifying foreign banking organization requirements of section 211.23(a), (c) or (e) of the Board's Regulation K (12 CFR 211.23(a), (c) or (e)), as applicable; or

(B) With respect to a banking entity that is not a foreign banking organization, the banking entity is not organized under the laws of the United States or of one or more States and the banking entity, on a fully-consolidated basis, meets at least two of the following requirements:

(1) Total assets of the banking entity held outside of the United States exceed total assets of the banking entity held in the United States;

(2) Total revenues derived from the business of the banking entity outside of the United States exceed total revenues derived from the business of the banking entity in the United States; or

(3) Total net income derived from the business of the banking entity outside of the United States exceeds total net income derived from the business of the banking entity in the United States.

(3) An ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of paragraph (b)(1)(iii) of this section only if it is sold or has been sold pursuant to an offering that does not target residents of the United States.

(4) An activity or investment occurs solely outside of the United States for purposes of paragraph (b)(1)(iv) of this section only if:

(i) The banking entity acting as sponsor, or engaging as principal in the acquisition or retention of an ownership interest in the covered fund, is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or organized under the laws of the United States or of any State;

(ii) The banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any State;

(iii) The investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly on a consolidated basis by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State; and

(iv) No financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any State.

(5) For purposes of this section, a U.S. branch, agency, or subsidiary of a foreign bank, or any subsidiary thereof, is located in the United States; however, a foreign bank of which that branch, agency, or subsidiary is a part is not considered to be located in the United States solely by virtue of operation of the U.S. branch, agency, or subsidiary.

(c) Permitted covered fund interests and activities by a regulated insurance company. The prohibition contained in § 255.10(a) of this subpart does not apply to the acquisition or retention by an insurance company, or an affiliate thereof, of any ownership interest in, or the sponsorship of, a covered fund only if:

(1) The insurance company or its affiliate acquires and retains the ownership interest solely for the general account of the insurance company or for one or more separate accounts established by the insurance company;

(2) The acquisition and retention of the ownership interest is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(3) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and foreign jurisdictions, as appropriate, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(2) of this section is insufficient to protect the safety and soundness of the banking entity, or the financial stability of the United States.

§ 255.14 Limitations on relationships with a covered fund.

(a) Relationships with a covered fund. (1) Except as provided for in paragraph (a)(2) of this section, no 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 § 255.11 of this subpart, or that continues to hold an ownership interest in accordance with § 255.11(b) of this subpart, and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of § 255.11, § 255.12, or § 255.13 of this subpart; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such banking entity (or an affiliate thereof) has taken an ownership interest, if:

(A) The banking entity is in compliance with each of the limitations set forth in § 255.11 of this subpart with respect to a covered fund organized and offered by such banking entity (or an affiliate thereof);

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually to the SEC (with a duty to update the certification if the information in the certification materially changes) 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; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

(b) *Restrictions on transactions with covered funds.* A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § 255.11 of this subpart, or that continues to hold an ownership interest in accordance with § 255.11(b) of this subpart, shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1), as if such banking entity were a member bank and such covered fund were an affiliate thereof.

(c) *Restrictions on prime brokerage transactions.* A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1) as if the counterparty were an affiliate of the banking entity.

§ 255.15 Other limitations on permitted covered fund activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ 255.11 through 255.13 of this subpart if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.

(b) *Definition of material conflict of interest.* (1) For purposes of this section, a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, and the banking entity has not taken at least one of the actions in paragraph (b)(2) of this section.

(2) Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, the banking entity:

(i) *Timely and effective disclosure.* (A) Has made clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(B) Such disclosure is made in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(ii) *Information barriers.* Has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) Definition of high-risk asset and high-risk trading strategy. For purposes of this section:

(1) *High-risk asset* means an asset or group of related assets that would, if held by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

(2) *High-risk trading strategy* means a trading strategy that would, if engaged in by a banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the United States.

§ 255.16 Ownership of interests in and sponsorship of issuers of certain collateralized debt obligations backed by trust-preferred securities.

(a) The prohibition contained in § 255.10(a)(1) does not apply to the ownership by a banking entity of an interest in, or sponsorship of, any issuer if:

(1) The issuer was established, and the interest was issued, before May 19, 2010;

(2) The banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral; and

(3) The banking entity acquired such interest on or before December 10, 2013 (or acquired such interest in connection with a merger with or acquisition of a banking entity that acquired the interest on or before December 10, 2013).

(b) For purposes of this § 255.16, *Qualifying TruPS Collateral* shall mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, as of the end of any reporting period within 12 months immediately preceding the issuance of such trust preferred security or subordinated debt instrument, had total consolidated assets of less than $15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company.

(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 §§ 255.4 and 255.11.

(d) Without limiting the applicability of paragraph (a) of this section, the Board, the FDIC and the OCC will make public a non-exclusive list of issuers that meet the requirements of paragraph (a). A banking entity may rely on the list published by the Board, the FDIC and the OCC.

§§ 255.17–255.19 [Reserved]

Subpart D—Compliance Program Requirement; Violations

§ 255.20 Program for compliance; reporting.

(a) *Program requirement.* 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 this part. The terms, scope and detail of the compliance program shall be appropriate for the types, size, scope and complexity of activities and business structure of the banking entity.

(b) *Contents of compliance program.* Except as provided in paragraph (f) of this section, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Written policies and procedures reasonably designed to document, describe, monitor and limit trading activities subject to subpart B (including those permitted under §§ 255.3 to 255.6 of subpart B), including setting, monitoring and managing required limits set out in § 2554 and § 2555, and activities and investments with respect to a covered fund subject to subpart C (including those permitted under §§ 255.11 through 255.14 of subpart C) conducted by the banking entity to ensure that all activities and investments conducted by the banking entity that are subject to section 13 of the BHC Act and this part comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor compliance with section 13 of the BHC Act and this part and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part and includes appropriate management review of trading limits, strategies, hedging activities, investments, incentive compensation and other matters identified in this part or by management as requiring attention;

(4) Independent testing and audit of the effectiveness of the compliance program conducted periodically by qualified personnel of the banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a banking entity must promptly provide to the SEC upon request and retain for a period of no less than 5 years or such longer period as required by the SEC.

(c) *Additional standards.* In addition to the requirements in paragraph (b) of this section, the compliance program of a banking entity must satisfy the requirements and other standards contained in Appendix B, if:

(1) The banking entity engages in proprietary trading permitted under subpart B and is required to comply with the reporting requirements of paragraph (d) of this section;

(2) The banking entity has reported total consolidated assets as of the previous calendar year end of $50 billion or more or, in the case of a foreign banking entity, has total U.S. assets as of the previous calendar year end of $50 billion or more (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States); or

(3) The SEC notifies the banking entity in writing that it must satisfy the requirements and other standards contained in Appendix B to this part.

(d) *Reporting requirements under Appendix A to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in Appendix A, if:

(i) The banking entity (other than a foreign banking entity as provided in paragraph (d)(1)(ii) of this section) has, together with its affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section;

(ii) In the case of a foreign banking entity, the average gross sum of the trading assets and liabilities of the combined U.S. operations of the foreign banking entity (including all subsidiaries, affiliates, branches and agencies of the foreign banking entity operating, located or organized in the United States and excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals or exceeds the threshold established in paragraph (d)(2) of this section; or

(iii) The SEC notifies the banking entity in writing that it must satisfy the reporting requirements contained in Appendix A.

(2) The threshold for reporting under paragraph (d)(1) of this section shall be $50 billion beginning on June 30, 2014; $25 billion beginning on April 30, 2016; and $10 billion beginning on December 31, 2016.

(3) Frequency of reporting: Unless the SEC notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with paragraph (d)(1) of this section) shall report the information required by Appendix A for each calendar month within 30 days of the end of the relevant calendar month; beginning with information for the month of January 2015, such information shall be reported within 10 days of the end of each calendar month. Any other banking entity subject to Appendix A shall report the information required by Appendix A for each calendar quarter within 30 days of the end of that calendar quarter unless the SEC notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* Any banking entity that has more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years shall maintain records that include:

(1) Documentation of the exclusions or exemptions other than sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund;

(2) For each fund sponsored by the banking entity (including all subsidiaries and affiliates) for which the banking entity relies on one or more of the exclusions from the definition of covered fund provided by §§ 255.10(c)(1), 255.10(c)(5), 255.10(c)(8), 255.10(c)(9), or 255.10(c)(10) of subpart C, documentation supporting the banking entity's determination that the fund is not a covered fund pursuant to one or more of those exclusions;

(3) For each seeding vehicle described in § 255.10(c)(12)(i) or (iii) of subpart C that will become a registered investment

company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § 255.12(a)(2)(i)(B) of subpart C;

(4) For any banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State, if the aggregate amount of ownership interests in foreign public funds that are described in § 255.10(c)(1) of subpart C owned by such banking entity (including ownership interests owned by any affiliate that is controlled directly or indirectly by a banking entity that is located in or organized under the laws of the United States or of any State) exceeds $50 million at the end of two or more consecutive calendar quarters, beginning with the next succeeding calendar quarter, documentation of the value of the ownership interests owned by the banking entity (and such affiliates) in each foreign public fund and each jurisdiction in which any such foreign public fund is organized, calculated as of the end of each calendar quarter, which documentation must continue until the banking entity's aggregate amount of ownership interests in foreign public funds is below $50 million for two consecutive calendar quarters; and

(5) For purposes of paragraph (e)(4) of this section, a U.S. branch, agency, or subsidiary of a foreign banking entity is located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

(f) *Simplified programs for less active banking entities*—(1) *Banking entities with no covered activities.* A banking entity that does not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § 255.6(a) of subpart B) may satisfy the requirements of this section by establishing the required compliance program prior to becoming engaged in such activities or making such investments (other than trading activities permitted pursuant to § 255.6(a) of subpart B).

(2) *Banking entities with modest activities.* A banking entity with total consolidated assets of $10 billion or less as reported on December 31 of the previous two calendar years that engages in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted under § 255.6(a) of subpart B) may satisfy the requirements of this section by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope and complexity of the banking entity.

§ 255.21 Termination of activities or investments; penalties for violations.

(a) Any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part, or acts in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall, upon discovery, promptly terminate the activity and, as relevant, dispose of the investment.

(b) Whenever the SEC finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or this part, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or this part, the SEC may take any action permitted by law to enforce compliance with section 13 of the BHC Act and this part, including directing the banking entity to restrict, limit, or terminate any or all activities under this part and dispose of any investment.

Appendix A to Part 255—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B (''proprietary trading restrictions''). Pursuant to § 255.20(d), this appendix generally applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the SEC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 255.20 and Appendix B.

b. The purpose of this appendix is to assist banking entities and the SEC in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 255.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 255.4, 255.5, or 255.6(a)–(b) (*i.e.,* underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the SEC of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. The quantitative measurements that must be furnished pursuant to this appendix are *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In order to allow banking entities and the Agencies to evaluate the effectiveness of these metrics, banking entities must collect and report these metrics for all trading desks beginning on the dates established in § 255.20 of the final rule. The Agencies will review the data collected and revise this collection requirement as appropriate based on a review of the data collected prior to September 30, 2015.

e. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 255.20 and Appendix B to this part. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (*e.g.,* whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

f. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 255.4 through 255.6(a) and (b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the SEC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 255.2 and 255.3. In addition, for purposes of this appendix, the following definitions apply:

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 255.4, 255.5, 255.6(a), or 255.6(b). A banking entity may include trading under §§ 255.3(d), 255.6(c), 255.6(d) or 255.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading desk means 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.

III. Reporting and Recordkeeping of Quantitative Measurements

a. Scope of Required Reporting

General scope. Each banking entity made subject to this part by § 255.20 must furnish the following quantitative measurements for each trading desk of the banking entity, calculated in accordance with this appendix:

- Risk and Position Limits and Usage;
- Risk Factor Sensitivities;
- Value-at-Risk and Stress VaR;
- Comprehensive Profit and Loss Attribution;
- Inventory Turnover;
- Inventory Aging; and
- Customer-Facing Trade Ratio

b. Frequency of Required Calculation and Reporting

A banking entity must calculate any applicable quantitative measurement for each trading day. A banking entity must report each applicable quantitative measurement to the SEC on the reporting schedule established in § 255.20 unless otherwise requested by the SEC. All quantitative measurements for any calendar month must be reported within the time period required by § 255.20.

c. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the SEC pursuant to this appendix and § 255.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the SEC to verify the accuracy of such reports, for a period of 5 years from the end of the calendar year for which the measurement was taken.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the portion of the trading desk's limits that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited, to the limits set out in § 255.4 and § 255.5. A number of the metrics that are described below, including ''Risk Factor Sensitivities'' and ''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 activities under § 255.4(b) and hedging activity under § 255.5. Accordingly, the limits required under § 255.4(b)(2)(iii) and § 255.5(b)(1)(i) must meet the applicable requirements under § 255.4(b)(2)(iii) and § 255.5(b)(1)(i) and also must include appropriate metrics for the trading desk limits including, at a minimum, the ''Risk Factor Sensitivities'' and ''Value-at-Risk and Stress Value-at-Risk'' metrics except to the extent any of the ''Risk Factor Sensitivities'' or ''Value-at-Risk and Stress Value-at-Risk'' metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

ii. *General Calculation Guidance:* Risk and Position Limits must be reported in the format used by the banking entity for the purposes of risk management of each trading desk. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached must be reported.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

2. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk.

ii. *General Calculation Guidance:* A banking entity must report the Risk Factor Sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. The underlying data and methods used to compute a trading desk's Risk Factor Sensitivities will depend on the specific function of the trading desk and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading desk, and furnished to the SEC, will depend on the explicit risks assumed by the trading desk. In general, however, reported Risk Factor Sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings.

A. Trading desks must take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:

- *Commodity derivative positions:* Risk factors with respect to the related commodities set out in 17 CFR 20.2, the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Credit positions:* Risk factors with respect to credit spreads that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and risk factors with respect to interest rates of all relevant maturities;
- *Credit-related derivative positions:* Risk factor sensitivities, for example credit spreads, shifts (parallel and non-parallel) in credit spreads—volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity derivative positions:* Risk factor sensitivities such as equity positions, volatility, and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;
- *Equity positions:* Risk factors for equity prices and risk factors that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;
- *Foreign exchange derivative positions:* Risk factors with respect to major currency pairs and maturities, exposure to interest rates at relevant maturities, volatility, and/or

correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and

- *Interest rate positions, including interest rate derivative positions:* Risk factors with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and shifts (parallel and non-parallel) in the interest rate curve, as well as the maturity profile of the positions.

B. The methods used by a banking entity to calculate sensitivities to a common factor shared by multiple trading desks, such as an equity price factor, must be applied consistently across its trading desks so that the sensitivities can be compared from one trading desk to another.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Value-at-Risk and Stress Value-at-Risk

i. *Description:* For purposes of this appendix, Value-at-Risk (''VaR'') is the commonly used percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on current market conditions. For purposes of this appendix, Stress Value-at-Risk (''Stress VaR'') is the percentile measurement of the risk of future financial loss in the value of a given set of aggregated positions over a specified period of time, based on market conditions during a period of significant financial stress.

ii. *General Calculation Guidance:* Banking entities must compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading desk that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR must be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading desk does not have a standalone VaR or Stress VaR calculation but is part of a larger aggregation of positions for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading desk's holdings must be performed consistent with the VaR or Stress VaR model and methodology used for the larger aggregation of positions.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) Profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day (''existing positions''); (ii) profit and loss attributable to new positions resulting from the current day's trading activity (''new positions''); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. In addition, profit and loss measurements must calculate volatility of comprehensive profit and loss (*i.e.,* the standard deviation of the trading desk's one-day profit and loss, in dollar terms) for the reporting period for at least a 30-, 60- and 90-day lag period, from the end of the reporting period, and any other period that the banking entity deems necessary to meet the requirements of the rule.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day. The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific Risk Factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. The comprehensive profit and loss attributed to new positions must reflect commissions and fee income or expense and market gains or losses associated with transactions executed on the applicable day. New positions include purchases and sales of financial instruments and other assets/liabilities and negotiated amendments to existing positions. The comprehensive profit and loss from new positions may be reported in the aggregate and does not need to be further attributed to specific sources.

C. The portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *General Calculation Guidance:* The specific categories used by a trading desk in the attribution analysis and amount of detail for the analysis should be tailored to the type and amount of trading activities undertaken by the trading desk. The new position attribution must be computed by calculating the difference between the prices at which instruments were bought and/or sold and the prices at which those instruments are marked to market at the close of business on that day multiplied by the notional or principal amount of each purchase or sale. Any fees, commissions, or other payments received (paid) that are associated with transactions executed on that day must be added (subtracted) from such difference. These factors must be measured consistently over time to facilitate historical comparisons.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

c. Customer-Facing Activity Measurements

1. Inventory Turnover

i. *Description:* For purposes of this appendix, Inventory Turnover is a ratio that measures the turnover of a trading desk's inventory. The numerator of the ratio is the absolute value of all transactions over the reporting period. The denominator of the ratio is the value of the trading desk's inventory at the beginning of the reporting period.

ii. *General Calculation Guidance:* For purposes of this appendix, for derivatives, other than options and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

2. Inventory Aging

i. *Description:* For purposes of this appendix, Inventory Aging generally describes a schedule of the trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held. Inventory Aging should measure the age profile of the trading desk's assets and liabilities.

ii. *General Calculation Guidance:* In general, Inventory Aging must be computed using a trading desk's trading activity data and must identify the value of a trading desk's aggregate assets and liabilities. Inventory Aging must include two schedules, an asset-aging schedule and a liability-aging schedule. Each schedule must record the value of assets or liabilities held over all holding periods. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value and, for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* One trading day.

iv. *Measurement Frequency:* Daily.

3. Customer-Facing Trade Ratio—Trade Count Based and Value Based

i. *Description:* For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing (i) the transactions involving a counterparty that is a customer of the trading desk to (ii) the transactions involving a counterparty that is not a customer of the trading desk. A trade count based ratio must be computed that records the number of transactions involving a counterparty that is a customer of the trading desk and the number of transactions involving a counterparty that is not a customer of the trading desk. A value based ratio must be computed that records the value of transactions involving a counterparty that is a customer of the trading desk and the value of transactions involving a counterparty that is not a customer of the trading desk.

ii. *General Calculation Guidance:* For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading desk if the counterparty is a market participant that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services. However, a trading desk or other organizational unit of another banking entity would not be a client, customer, or counterparty of the trading desk if the other entity has trading assets and liabilities of $50 billion or more as measured in accordance with § 255.20(d)(1) unless the trading desk documents how and why a particular trading desk or other organizational unit of the entity should be treated as a client, customer, or counterparty of the trading desk. Transactions conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants would be considered transactions with customers of the trading desk. For derivatives, other than options, and interest rate derivatives, value means gross notional value, for options, value means delta adjusted notional value, and for interest rate derivatives, value means 10-year bond equivalent value.

iii. *Calculation Period:* 30 days, 60 days, and 90 days.

iv. *Measurement Frequency:* Daily.

Appendix B to Part 255—Enhanced Minimum Standards for Compliance Programs

I. Overview

Section 255.20(c) requires certain banking entities to establish, maintain, and enforce an enhanced compliance program that includes the requirements and standards in this Appendix as well as the minimum written policies and procedures, internal controls, management framework, independent testing, training, and recordkeeping provisions outlined in § 255.20. This Appendix sets forth additional minimum standards with respect to the establishment, oversight, maintenance, and enforcement by these banking entities of an enhanced internal compliance program for ensuring and monitoring 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 this part.

a. This compliance program must:

1. Be reasonably designed to identify, document, monitor, and report the permitted trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these covered activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and this part;

2. Establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and this part;

3. Subject the effectiveness of the compliance program to periodic independent review and testing, and ensure that the entity's internal audit, corporate compliance and internal control functions involved in review and testing are effective and independent;

4. Make senior management, and others as appropriate, accountable for the effective implementation of the compliance program, and ensure that the board of directors and chief executive officer (or equivalent) of the banking entity review the effectiveness of the compliance program; and

5. Facilitate supervision and examination by the Agencies of the banking entity's permitted trading and covered fund activities and investments.

II. Enhanced Compliance Program

a. *Proprietary Trading Activities.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, and complexity of, and risks associated with, its permitted trading activities. The compliance program may be tailored to the types of trading activities conducted by the banking entity, and must include a detailed description of controls established by the banking entity to reasonably ensure that its trading activities are conducted in accordance with the requirements and limitations applicable to those trading activities under section 13 of the BHC Act and this part, and provide for appropriate revision of the compliance program before expansion of the trading activities of the banking entity. A banking entity must devote adequate resources and use knowledgeable personnel in conducting, supervising and managing its trading activities, and promote consistency, independence and rigor in implementing its risk controls and compliance efforts. The compliance program must be updated with a frequency sufficient to account for changes in the activities of the banking entity, results of independent testing of the program, identification of weaknesses in the program, and changes in legal, regulatory or other requirements.

1. *Trading Desks:* The banking entity must have written policies and procedures governing each trading desk that include a description of:

i. The process for identifying, authorizing and documenting financial instruments each trading desk may purchase or sell, with separate documentation for market making-related activities conducted in reliance on §255.4(b) and for hedging activity conducted in reliance on § 255.5;

ii. A mapping for each trading desk to the division, business line, or other organizational structure that is responsible for managing and overseeing the trading desk's activities;

iii. The mission (*i.e.,* the type of trading activity, such as market-making, trading in sovereign debt, etc.) and strategy (*i.e.,* methods for conducting authorized trading activities) of each trading desk;

iv. The activities that the trading desk is authorized to conduct, including (i) authorized instruments and products, and (ii) authorized hedging strategies, techniques and instruments;

v. The types and amount of risks allocated by the banking entity to each trading desk to implement the mission and strategy of the trading desk, including an enumeration of material risks resulting from the activities in which the trading desk is authorized to engage (including but not limited to price risks, such as basis, volatility and correlation risks, as well as counterparty credit risk). Risk assessments must take into account both the risks inherent in the trading activity and the strength and effectiveness of controls designed to mitigate those risks;

vi. How the risks allocated to each trading desk will be measured;

vii. Why the allocated risks levels are appropriate to the activities authorized for the trading desk;

viii. The limits on the holding period of, and the risk associated with, financial instruments under the responsibility of the trading desk;

ix. The process for setting new or revised limits, as well as escalation procedures for granting exceptions to any limits or to any policies or procedures governing the desk, the analysis that will be required to support revising limits or granting exceptions, and the process for independently reviewing and documenting those exceptions and the underlying analysis;

x. The process for identifying, documenting and approving new products, trading strategies, and hedging strategies;

xi. The types of clients, customers, and counterparties with whom the trading desk may trade; and

xii. The compensation arrangements, including incentive arrangements, for employees associated with the trading desk, which may not be designed to reward or incentivize prohibited proprietary trading or excessive or imprudent risk-taking.

2. *Description of risks and risk management processes:* The compliance program for the banking entity must include a comprehensive description of the risk management program for the trading activity of the banking entity. The compliance program must also include a description of the governance, approval, reporting, escalation, review and other processes the banking entity will use to reasonably ensure that trading activity is conducted in compliance with section 13 of the BHC Act and this part. Trading activity in similar financial instruments should be subject to similar governance, limits, testing, controls, and review, unless the banking entity specifically determines to establish different limits or processes and documents those differences. Descriptions must include, at a minimum, the following elements:

i. A description of the supervisory and risk management structure governing all trading activity, including a description of processes for initial and senior-level review of new products and new strategies;

ii. A description of the process for developing, documenting, testing, approving and reviewing all models used for valuing, identifying and monitoring the risks of trading activity and related positions, including the process for periodic independent testing of the reliability and accuracy of those models;

iii. A description of the process for developing, documenting, testing, approving and reviewing the limits established for each trading desk;

iv. A description of the process by which a security may be purchased or sold pursuant to the liquidity management plan, including the process for authorizing and monitoring such activity to ensure compliance with the banking entity's liquidity management plan and the restrictions on liquidity management activities in this part;

v. A description of the management review process, including escalation procedures, for approving any temporary exceptions or permanent adjustments to limits on the activities, positions, strategies, or risks associated with each trading desk; and

vi. The role of the audit, compliance, risk management and other relevant units for conducting independent testing of trading and hedging activities, techniques and strategies.

3. *Authorized risks, instruments, and products.* The banking entity must implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that trading activity is conducted in conformance with section 13 of the BHC Act and this part and with the banking entity's written policies and procedures. The banking entity must establish and enforce risk limits appropriate for the activity of each trading desk. These limits should be based on probabilistic and non-probabilistic measures of potential loss (*e.g.,* Value-at-Risk and notional exposure, respectively), and measured under normal and stress market conditions. At a minimum, these internal controls must monitor, establish and enforce limits on:

i. The financial instruments (including, at a minimum, by type and exposure) that the trading desk may trade;

ii. The types and levels of risks that may be taken by each trading desk; and

iii. The types of hedging instruments used, hedging strategies employed, and the amount of risk effectively hedged.

4. *Hedging policies and procedures.* The banking entity must establish, maintain, and enforce written policies and procedures regarding the use of risk-mitigating hedging instruments and strategies that, at a minimum, describe:

i. The positions, techniques and strategies that each trading desk may use to hedge the risk of its positions;

ii. The manner in which the banking entity will identify the risks arising in connection with and related to the individual or aggregated positions, contracts or other holdings of the banking entity that are to be hedged and determine that those risks have been properly and effectively hedged;

iii. The level of the organization at which hedging activity and management will occur;

iv. The manner in which hedging strategies will be monitored and the personnel responsible for such monitoring;

v. The risk management processes used to control unhedged or residual risks; and

vi. The process for developing, documenting, testing, approving and reviewing all hedging positions, techniques and strategies permitted for each trading desk and for the banking entity in reliance on § 255.5.

5. *Analysis and quantitative measurements.* The banking entity must perform robust analysis and quantitative measurement of its trading activities that is reasonably designed to ensure that the trading activity of each trading desk is consistent with the banking entity's compliance program; monitor and assist in the identification of potential and actual prohibited proprietary trading activity; and prevent the occurrence of prohibited proprietary trading. Analysis and models used to determine, measure and limit risk must be rigorously tested and be reviewed by management responsible for trading activity to ensure that trading activities, limits, strategies, and hedging activities do not understate the risk and exposure to the banking entity or allow prohibited proprietary trading. This review should include periodic and independent back-testing and revision of activities, limits, strategies and hedging as appropriate to contain risk and ensure compliance. In addition to the quantitative measurements reported by any banking entity subject to Appendix A to this part, each banking entity must develop and implement, to the extent appropriate to facilitate compliance with this part, additional quantitative measurements specifically tailored to the particular risks, practices, and strategies of its trading desks. The banking entity's analysis and quantitative measurements must incorporate the quantitative measurements reported by the banking entity pursuant to Appendix A (if applicable) and include, at a minimum, the following:

i. Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of quantitative measurements;

ii. Ongoing, timely monitoring and review of calculated quantitative measurements;

iii. The establishment of numerical thresholds and appropriate trading measures for each trading desk and heightened review of trading activity not consistent with those thresholds to ensure compliance with section 13 of the BHC Act and this part, including analysis of the measurement results or other information, appropriate escalation procedures, and documentation related to the review; and

iv. Immediate review and compliance investigation of the trading desk's activities, escalation to senior management with oversight responsibilities for the applicable trading desk, timely notification to the SEC, appropriate remedial action (*e.g.,* divesting of impermissible positions, cessation of impermissible activity, disciplinary actions), and documentation of the investigation findings and remedial action taken when quantitative measurements or other information, considered together with the facts and circumstances, or findings of internal audit, independent testing or other review suggest a reasonable likelihood that the trading desk has violated any part of section 13 of the BHC Act or this part.

6. *Other Compliance Matters.* In addition to the requirements specified above, the banking entity's compliance program must:

i. Identify activities of each trading desk that will be conducted in reliance on exemptions contained in §§ 255.4 through 255.6, including an explanation of:

A. How and where in the organization the activity occurs; and

B. Which exemption is being relied on and how the activity meets the specific requirements for reliance on the applicable exemption;

ii. Include an explanation of the process for documenting, approving and reviewing actions taken pursuant to the liquidity management plan, where in the organization this activity occurs, the securities permissible for liquidity management, the process for ensuring that liquidity management activities are not conducted for the purpose of prohibited proprietary trading, and the process for ensuring that securities purchased as part of the liquidity management plan are highly liquid and conform to the requirements of this part;

iii. Describe how the banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each trading desk that relies on the exemptions contained in §§ 255.3(d)(3), and 255.4 through 255.6, which must take into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in value cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that result in large and significant concentrations to sectors, risk factors, or counterparties;

iv. Establish responsibility for compliance with the reporting and recordkeeping requirements of subpart B and § 255.20; and

v. Establish policies for monitoring and prohibiting potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties.

7. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any trading activity that may indicate potential violations of section 13 of the BHC Act and this part and to prevent actual violations of section 13 of the BHC Act and this part. The compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt

notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

b. *Covered Fund Activities or Investments.* A banking entity must establish, maintain and enforce a compliance program that includes written policies and procedures that are appropriate for the types, size, complexity and risks of the covered fund and related activities conducted and investments made, by the banking entity.

1. *Identification of covered funds.* The banking entity's compliance program must provide a process, which must include appropriate management review and independent testing, for identifying and documenting covered funds that each unit within the banking entity's organization sponsors or organizes and offers, and covered funds in which each such unit invests. In addition to the documentation requirements for covered funds, as specified under § 255.20(e), the documentation must include information that identifies all pools that the banking entity sponsors or has an interest in and the type of exemption from the Commodity Exchange Act (whether or not the pool relies on section 4.7 of the regulations under the Commodity Exchange Act), and the amount of ownership interest the banking entity has in those pools.

2. *Identification of covered fund activities and investments.* The banking entity's compliance program must identify, document and map each unit within the organization that is permitted to acquire or hold an interest in any covered fund or sponsor any covered fund and map each unit to the division, business line, or other organizational structure that will be responsible for managing and overseeing that unit's activities and investments.

3. *Explanation of compliance.* The banking entity's compliance program must explain how:

i. The banking entity monitors for and prohibits potential or actual material conflicts of interest between the banking entity and its clients, customers, or counterparties related to its covered fund activities and investments;

ii. The banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the banking entity related to its covered fund activities and investments; and

iii. The banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by its covered fund activities and investments, taking into account potential or actual exposure to:

A. Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

B. Assets whose changes in values cannot be adequately mitigated by effective hedging;

C. New products with rapid growth, including those that do not have a market history;

D. Assets or strategies that include significant embedded leverage;

E. Assets or strategies that have demonstrated significant historical volatility;

F. Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

G. Assets or strategies that expose the banking entity to large and significant concentrations with respect to sectors, risk factors, or counterparties;

4. *Description and documentation of covered fund activities and investments.* For each organizational unit engaged in covered fund activities and investments, the banking entity's compliance program must document:

i. The covered fund activities and investments that the unit is authorized to conduct;

ii. The banking entity's plan for actively seeking unaffiliated investors to ensure that any investment by the banking entity conforms to the limits contained in § 255.12 or registered in compliance with the securities laws and thereby exempt from those limits within the time periods allotted in§ 255.12; and

iii. How it complies with the requirements of subpart C.

5. *Internal Controls.* A banking entity must establish, maintain, and enforce internal controls that are reasonably designed to ensure that its covered fund activities or investments comply with the requirements of section 13 of the BHC Act and this part and are appropriate given the limits on risk established by the banking entity. These written internal controls must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part. The internal controls must, at a minimum require:

i. Monitoring and limiting the banking entity's individual and aggregate investments in covered funds;

ii. Monitoring the amount and timing of seed capital investments for compliance with the limitations under subpart C (including but not limited to the redemption, sale or disposition requirements) of § 255.12, and the effectiveness of efforts to seek unaffiliated investors to ensure compliance with those limits;

iii. Calculating the individual and aggregate levels of ownership interests in one or more covered fund required by § 255.12;

iv. Attributing the appropriate instruments to the individual and aggregate ownership interest calculations above;

v. Making disclosures to prospective and actual investors in any covered fund organized and offered or sponsored by the banking entity, as provided under § 255.11(a)(8);

vi. Monitoring for and preventing any relationship or transaction between the banking entity and a covered fund that is prohibited under § 255.14, including where the banking entity has been designated as the sponsor, investment manager, investment adviser, or commodity trading advisor to a covered fund by another banking entity; and

vii. Appropriate management review and supervision across legal entities of the banking entity to ensure that services and products provided by all affiliated entities comply with the limitation on services and products contained in § 255.14.

6. *Remediation of violations.* The banking entity's compliance program must be reasonably designed and established to effectively monitor and identify for further analysis any covered fund activity or investment that may indicate potential violations of section 13 of the BHC Act or this part and to prevent actual violations of section 13 of the BHC Act and this part. The banking entity's compliance program must describe procedures for identifying and remedying violations of section 13 of the BHC Act and this part, and must include, at a minimum, a requirement to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, including § 255.21, and document all proposed and actual remediation efforts. The compliance program must include specific written policies and procedures that are reasonably designed to assess the extent to which any activity or investment indicates that modification to the banking entity's compliance program is warranted and to ensure that appropriate modifications are implemented. The written policies and procedures must provide for prompt notification to appropriate management, including senior management and the board of directors, of any material weakness or significant deficiencies in the design or implementation of the compliance program of the banking entity.

III. Responsibility and Accountability for the Compliance Program

a. A banking entity must establish, maintain, and enforce a governance and management framework to manage its business and employees with a view to preventing violations of section 13 of the BHC Act and this part. A banking entity must have an appropriate management framework reasonably designed to ensure that: Appropriate personnel are responsible and accountable for the effective implementation and enforcement of the compliance program; a clear reporting line with a chain of responsibility is delineated; and the compliance program is reviewed periodically by senior management. The board of directors (or equivalent governance body) and senior management should have the appropriate authority and access to personnel and information within the organizations as well as appropriate resources to conduct their oversight activities effectively.

1. *Corporate governance.* The banking entity must adopt a written compliance program approved by the board of directors, an appropriate committee of the board, or equivalent governance body, and senior management.

2. *Management procedures.* The banking entity must establish, maintain, and enforce a governance framework that is reasonably designed to achieve compliance with section 13 of the BHC Act and this part, which, at a minimum, provides for:

i. The designation of appropriate senior management or committee of senior management with authority to carry out the management responsibilities of the banking entity for each trading desk and for each organizational unit engaged in covered fund activities;

ii. Written procedures addressing the management of the activities of the banking entity that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, including:

A. A description of the management system, including the titles, qualifications, and locations of managers and the specific responsibilities of each person with respect to the banking entity's activities governed by section 13 of the BHC Act and this part; and

B. Procedures for determining compensation arrangements for traders engaged in underwriting or market making-related activities under § 255.4 or risk-mitigating hedging activities under § 255.5 so that such compensation arrangements are designed not to reward or incentivize prohibited proprietary trading and appropriately balance risk and financial results in a manner that does not encourage employees to expose the banking entity to excessive or imprudent risk.

3. *Business line managers.* Managers with responsibility for one or more trading desks of the banking entity are accountable for the effective implementation and enforcement of the compliance program with respect to the applicable trading desk(s).

4. *Board of directors, or similar corporate body, and senior management.* The board of directors, or similar corporate body, and senior management are responsible for setting and communicating an appropriate culture of compliance with section 13 of the BHC Act and this part and ensuring that appropriate policies regarding the management of trading activities and covered fund activities or investments are adopted to comply with section 13 of the BHC Act and this part. The board of directors or similar corporate body (such as a designated committee of the board or an equivalent governance body) must ensure that senior management is fully capable, qualified, and properly motivated to manage compliance with this part in light of the organization's business activities and the expectations of the board of directors. The board of directors or similar corporate body must also ensure that senior management has established appropriate incentives and adequate resources to support compliance with this part, including the implementation of a compliance program meeting the requirements of this appendix into management goals and compensation structures across the banking entity.

5. *Senior management.* Senior management is responsible for implementing and enforcing the approved compliance program. Senior management must also ensure that effective corrective action is taken when failures in compliance with section 13 of the BHC Act and this part are identified. Senior management and control personnel charged with overseeing compliance with section 13 of the BHC Act and this part should review the compliance program for the banking entity periodically and report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading activities and covered fund activities or investments, which shall be at least annually.

6. *CEO attestation.* Based on a review by the CEO of the banking entity, the CEO of the banking entity must, annually, attest in writing to the SEC that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established under this Appendix and § 255.20 of this part in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and this part. In the case of a U.S. branch or agency of a foreign banking entity, the attestation may be provided for the entire U.S. operations of the foreign banking entity by the senior management officer of the United States operations of the foreign banking entity who is located in the United States.

IV. Independent Testing

a. Independent testing must occur with a frequency appropriate to the size, scope, and risk profile of the banking entity's trading and covered fund activities or investments, which shall be at least annually. This independent testing must include an evaluation of:

1. The overall adequacy and effectiveness of the banking entity's compliance program, including an analysis of the extent to which the program contains all the required elements of this appendix;

2. The effectiveness of the banking entity's internal controls, including an analysis and documentation of instances in which such internal controls have been breached, and how such breaches were addressed and resolved; and

3. The effectiveness of the banking entity's management procedures.

b. A banking entity must ensure that independent testing regarding the effectiveness of the banking entity's compliance program is conducted by a qualified independent party, such as the banking entity's internal audit department, compliance personnel or risk managers independent of the organizational unit being tested, outside auditors, consultants, or other qualified independent parties. A banking entity must promptly take appropriate action to remedy any significant deficiencies or material weaknesses in its compliance program and to terminate any violations of section 13 of the BHC Act or this part.

V. Training

Banking entities must provide adequate training to personnel and managers of the banking entity engaged in activities or investments governed by section 13 of the BHC Act or this part, as well as other appropriate supervisory, risk, independent testing, and audit personnel, in order to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the banking entity's trading activities and covered fund activities or investments.

VI. Recordkeeping

Banking entities must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A banking entity must retain these records for a period that is no less than 5 years or such longer period as required by the SEC in a form that allows it to promptly produce such records to the SEC on request.

Dated: August 19, 2019.

Joseph M. Otting,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, October 9, 2019.

Ann E. Misback,

Secretary of the Board.

Dated at Washington, DC, on August 20, 2019.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Valerie Jean Best,

Assistant Executive Secretary.

By the Securities and Exchange Commission.

Dated: September 18, 2019.

Vanessa A. Countryman.

Issued in Washington, DC, on October 11, 2019, by the Commodity Futures Trading Commission.

Christopher Kirkpatrick,

Secretary of the Commodity Futures Trading Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds—Commission Voting Summary and Commissioners' Statements

Appendix 1—CFTC Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative. The document submitted to the CFTC Commissioners for a vote did not include Section V.F. SEC Economic Analysis or Section V.G. Congressional Review Act.

Appendix 2—Statement of CFTC Chairman Heath Tarbert in Support of Revisions to the Volcker Rule

I have voted to approve revisions to the Volcker Rule, among the most well-intentioned but poorly designed regulations in the history of American finance. My involvement with the Volcker Rule started nearly a decade ago when I served as special counsel to the Senate Banking Committee before the passage of the Dodd-Frank Act. In fact, I was the staff member responsible for arranging for former Federal Reserve Chairman Paul Volcker to testify before the committee on the original version of the rule that now bears his name. Having had the opportunity to interact with Chairman Volcker at various points throughout my career, I have always had immense respect for him. He had a clear-cut vision: Banks should be barred from speculating in the markets (a practice known as proprietary trading) and from running hedge funds and private-equity firms. ''If you are doing this stuff,'' he would say, ''you should not be a commercial bank.''

Five federal agencies—the Federal Reserve, the FDIC, the OCC, the SEC, and the CFTC (together, the ''Agencies'')—issued final regulations in December 2013 to implement the statutory language of the Volcker Rule in Title VI of the Dodd-Frank Act. The basic premise of this law is to restrict financial institutions with deposits insured by the Federal Government from engaging in proprietary trading, but permit trading for market making, hedging, and other traditional financial services activities.

We now have five years of experience with the initial version of the regulations implementing the Volcker Rule, and over that time, a number of legitimate concerns have arisen. In my view, the initial regulations adopted by the Agencies have metastasized from Mr. Volcker's original, simple vision to the degree where his distinction between proprietary and non-proprietary trading is hardly recognizable. I agree with Mr. Volcker that the rule has become overly complex and hard to understand; [1] at this point it is also nearly unadministrable. Among other things, the regulations create confusion over what is acceptable activity for banking entities.[2] Indeed, the Agencies have had to issue 21 sets of frequently asked questions (''FAQs'') in the first three years since the regulations were adopted.[3] This is not a model of clear rulemaking. Furthermore, the Volcker Rule imposes highly intensive compliance burdens that unfairly benefit large Wall Street banks over smaller regional ones. No one ever intended these results.

In addition, the Volcker Rule has an extraterritorial reach that is breathtaking in its expansiveness, something I witnessed personally several years ago in Australia. There I met with a senior executive at a local, Australian financial institution. He handed me his business card, and it listed his title as ''Head of Volcker Rule Compliance.'' In Australia! We have created a mess not just for the United States, but for the whole world.

I do not doubt the good intentions of the original drafters of both the Volcker Rule and its implementing regulations. I continue to affirm that deposit insurance underwritten by the FDIC and discount window access provided by the Federal Reserve—both ultimately backstopped by U.S. taxpayers—should not subsidize non-banking activities.[4] I will not raise the related question whether non-banks affiliated with insured depository institutions should be allowed to engage in proprietary trading. I recognize that this is a decision for Congress, not me.[5]

As Chairman of the CFTC, my job is to ensure that the derivatives markets are liquid, resilient, and vibrant so they can serve the price discovery and risk management functions critical to our real economy. I have seen reports that liquidity in bond markets may have been adversely affected by the Volcker Rule.[6] I am concerned that the Volcker Rule may also affect liquidity in the derivatives markets. This could negatively impact the ability of agricultural, energy, manufacturing, and other companies in the real economy to engage in risk mitigation activities.

I am happy to say that the amended regulations we have now adopted help to simplify the Volcker Rule and include a number of important amendments that lessen the burden on smaller regional banks and benefit end users of derivatives. The amendments seek to tailor the Volcker Rule to increase efficiency, right-size firms' compliance obligations, and allow banking entities—especially smaller ones—to provide services to clients more efficiently.

The amended regulations adopt a risk-based approach that relies on a set of clearly articulated standards for prohibited and permitted activities and investments. In particular, the new regulations revise elements of the prohibition on proprietary trading to provide banking entities—including CFTC-registered swap dealers and futures commission merchants (''FCMs'')—with greater flexibility in their trading activities and simplified compliance procedures.

The final regulations also expand existing, and include additional, exclusions from the definition of proprietary trading. For example, the amended regulations add an exclusion for matched derivatives transactions to facilitate customer-driven swaps, especially by customers of small regional banks, which should benefit end users who rely on derivatives to hedge their commercial risks. The amended final regulations also expand the list of permissible products for the liquidity management exclusion to include FX forwards/swaps and cross-currency swaps. Banking entities commonly purchase and sell these instruments for the purpose of managing their liquidity and funding needs. This can ultimately benefit commercial firms who use banks for loans and other products to hedge their foreign exchange risks arising from import and export transactions.

In addition, the final regulations tailor the compliance and metrics reporting requirements of the Volcker Rule to focus on entities with relatively large trading operations. As a result, financial institutions on Wall Street will retain their reporting procedures, while smaller and more traditional commercial banks without major trading operations will get some relief. What

[1] *See, e.g.,* ''Why Paul Volcker Soured on His Own Rule,'' Time (Oct. 25, 2011), available at: *http://business.time.com/2011/10/25/why-paul-volcker-soured-on-the-volcker-rule;* ''Paul Volcker Says Volcker Rule Too Complicated,'' Reuters (Nov. 9, 2011), available at *https://www.reuters.com/article/us-regulation-volcker/paul-volcker-says-volcker-rule-too-complicated*. This is not to suggest that Mr. Volcker agrees with the proposed changes now before the interagency process. See ''Volcker the Man Blasts Volcker the Rule in Letter to Fed Chair,'' Bloomberg (Sept. 10, 2019), available at *https://www.bloomberg.com/news/articles/2019-09-10/volcker-the-man-blasts-volcker-the-rule-in-letter-to-fed-chair* (describing a private letter purportedly criticizing the proposed amendments to the current regulations).

[2] I have written a number of legal articles over the years to help market participants make sense of the Volcker Rule and how it might apply to them. See, *e.g., The Vagaries of the Volcker Rule,* Int'l Fin. L. Rev. (Sept. 2010); *The Volcker Rule and the Future of Private Equity* (co-author), Rev. of Banking & Fin. Serv. (May 2011); and *CLOs and the Volcker Rule* (co-author), Rev. of Banking & Fin. Serv. (Aug. 2015).

[3] *See* FAQ on Conformance Period (June 10, 2014); FAQ on Foreign Public Fund Seeding Vehicles (June 10, 2014); FAQ on Loan Securitization Servicing Assets (June 10, 2014); FAQ on Namesharing Prohibition (June 10, 2014); FAQ on Metrics Reporting Date (June 10, 2014); FAQ on Trading Desk (June 10, 2014); FAQ on Mortgage-Backed Securities of Government-Sponsored Enterprises (November 12, 2014); FAQ on Metrics Reporting During the Conformance Period (Nov. 13, 2014); FAQ on Annual CEO Attestation (Sept. 10, 2014); FAQ on Metrics Reporting and Confidentiality (Dec. 23, 2014); FAQ on Treasury STRIPS (Jan. 29, 2015); FAQ on 30-Day Metrics Reporting During the Conformance Period (Jan. 29, 2015); FAQ on SOTUS Covered Fund Exemption: Marketing Restriction (Feb. 27, 2015); FAQ on Foreign Public Funds Sponsored by Banking Entities (June 12, 2015); FAQ on Joint Venture Exclusion for Covered Funds (June 12, 2015); FAQ on Seeding Period Treatment of Registered Investment Companies and Foreign Public Funds (June 16, 2015); FAQ on CEO Certification for Prime Brokerage Transactions (Sept. 25, 2015); FAQ on Compliance for Market Making and the Identification of Covered Funds (Sept. 25, 2015); FAQ on Termination of Market-making Activity (Nov. 20, 2015); FAQ on Applicability of the Restrictions in Section 13(f) of the BHC Act (Nov. 20, 2015); FAQ on Capital Treatment of Banking Entity Investments in TruPS CDOs (Mar. 4, 2016).

[4] See Hearing Before the Committee on Banking, Housing, and Urban Affairs, United States Senate, 150th Congress, Session 1 (May 17, 2017) at 22 (''I [Heath Tarbert] believe that Federal deposit insurance should not subsidize nonbanking activities............... [This] should not be controversial.'').

[5] It is worth noting that the Dodd-Frank Act of 2010 contained a provision addressing the specific issue of insured banks engaging in trading activities perceived to go beyond traditional banking services. The ''push-out'' rule of Section 716, also known as the Lincoln Amendment, would have confined an insured depository institution's trading of swaps to those used for hedging or otherwise related to the well-known list of eligible (and appropriately conservative) investments permissible for national banks. Exotic and non-traditional products such as credit default swaps, equity swaps, and most physical commodity swaps would have been effectively ''pushed out'' out of insured banks and into non-bank affiliates not directly backstopped by U.S. taxpayers. Whatever the merits of the Lincoln Amendment, no one can deny that it was a clear rule aimed at an equally clear and widely-shared policy objective. But it was not to last. In December 2014, a bipartisan Congress passed—and President Obama signed into law—a budget bill containing a provision that largely gutted the original push-out rule of the Dodd-Frank Act. See Consolidated and Further Continuing Appropriations Act, 2015, Public Law 113–235, 128 Stat. 2130 at section 630 (2014).

[6] *See, e.g.,* M. Allahrakha & J. Cetina, et al., ''The Effects of the Volcker Rule on Corporate Bond Trading: Evidence from the Underwriting Exemption,'' OFR Working Paper (Aug. 6, 2019); J. Bao, & M. O'Hara, et al., *The Volcker Rule and Market-Making in Times of Stress,* J. of Fin. Econ. (2018); H. Bessembinder & S. Jacobsen, et al., *Capital Commitment and Illiquidity in Corporate Bonds,* J. of Fin. (Aug. 2018).

is more, the new regulations simplify requirements by clarifying prohibited and permissible activities, so that all institutions—including those headquartered abroad but who lend and deploy capital in the United States—have a better understanding of how to comply with our laws.

I believe laws should be as clear and concise as possible. The point of having laws is for people to follow them, but before they can follow them they first have to understand them. As Judge Learned Hand put it 90 years ago, ''The language of the law must not be foreign to the ears of those who are to obey it.'' [7] For too long the Volcker Rule has been just that—very peculiar and virtually unintelligible to market participants and regulators alike.

In short, the amended regulations will provide banking entities and their affiliates (including a number of swap dealers, FCMs, and commodity pools subject to CFTC oversight) with greater clarity and certainty about what activities are permitted under the Volcker Rule. The revised regulations will also generally reduce the compliance burden for these entities, which will benefit those end users of derivatives who are critical to our real economy. These changes, which will make the Volcker Rule simpler without reducing its fundamental benefits, are something we should all support.

Appendix 3—Supporting Statement of CFTC Commissioner Brian Quintenz

I support today's targeted amendments to the Volcker Rule, which I believe will simplify firms' compliance with the statutory ban on proprietary trading and improve the agencies' supervision of banking entities. Based upon the agencies' implementation experience since 2013, it has become apparent that the rule as originally adopted has resulted in ambiguity over permissible activities, an overbroad application, and unnecessarily complex compliance processes. The revised rule before us today tailors and simplifies the rule to enable banking entities to effectively provide traditional banking services to their clients in a manner that is consistent with the statute.

Adopting a risk-based approach, the revised rule tailors the scale of a banking entity's compliance program to be commensurate with the firm's size and level of trading activities. Under the final rule, the most stringent compliance requirements apply to those entities with the most significant amount of trading activities, while banks with simpler business models and more limited trading operations would be subject to tiered compliance requirements tailored to the complexity and scope of their activities. As a result, firms with little or no activity subject to the Volcker Rule's prohibitions will face lower compliance costs and reduced regulatory burdens. However, because activity implicated by the Volcker Rule is concentrated in a small number of banks, the agencies estimate that, even under this tiered approach, approximately 93% of the trading assets and liabilities in the U.S. banking system would continue to be held by firms subject to the strictest compliance standards.

The final rule also clarifies and simplifies the application of the short-term intent prong. Under the 2013 rule, the purchase (or sale) of a financial instrument by a banking entity was presumed to be for the trading account if the banking entity held the financial instrument for fewer than sixty days (or substantially transferred the risk of the financial instrument within 60 days of purchase or sale). In practice, firms have found it difficult to rebut the presumption, with the result that the short term intent prong has captured many activities that should not be included in the definition of proprietary trading. The final rule addresses this issue by reversing the rebuttable presumption, providing that the purchase or sale of a financial instrument presumptively lacks short-term trading intent if the banking entity holds the financial instrument for 60 days or longer. In addition, the final rule includes new or expanded exclusions from the definition of proprietary trading for liquidity management programs, certain customer-driven swaps, error trades, and certain traditional banking activities, such as the hedging of mortgage servicing rights. These modifications clarify the scope of permissible activities and ensure that the application of the proprietary trading ban is not overbroad.

I believe today's final rule serves as an example of effective cooperation among five regulators: The CFTC; the Securities and Exchange Commission; the Federal Reserve Board; the Office of the Comptroller of the Currency; and the Federal Deposit Insurance Corporation. The agencies have come together to address many of the unintended consequences of the prior rule, while continuing to comply with statutory requirements. Finally, I would like to thank the staff of the Division of Swap Dealer and Intermediary Oversight for their efforts on this matter.

Appendix 4—Dissenting Statement of CFTC Commissioner Rostin Behnam

I respectfully dissent as to the Commission's decision to approve revisions to the Volcker Rule. In June 2018, when I voted against the proposed rule, I expressed that my biggest concern was that our action would encourage a return to the risky activities that led to the financial crisis, and perhaps further consolidate trading activity into a few institutions.[1] My concern last June was that we were weakening the Volcker Rule around the edges, and I raised specific issues regarding unnecessary complexity, lack of clarity, and a flawed process that chilled dissent. Unfortunately, today's final rule does not do anything to assuage these concerns. To make matters worse, while the proposal merely threatened to kill Volcker through a thousand little cuts, the final rule goes for the throat. It significantly weakens the prohibition on proprietary trading by narrowing the scope of financial instruments subject to the Volcker Rule. What remains is so watered down that it leaves one questioning whether it should be called the Volcker rule at all. To that point, Paul Volcker himself recently sent a letter to the Chairman of the Federal Reserve criticizing the rule and stating that the rule ''amplifies risk in the financial system, increases moral hazard and erodes protections against conflicts of interest that were so glaringly on display during the last crisis.'' [2]

In my dissent last June, I pointed out that the proposal further complicated the Volcker rule while calling it simplification. We do the same thing in the final rule. Where once there was one set of rules for all banking entities, there will now be three categories of banking entities with different rules for each: Banking entities with Significant trading assets and liabilities, banking entities with Limited trading assets and liabilities, banking entities in between with Moderate trading assets and liabilities. While numerous commenters expressed concerns with this three-tiered compliance framework, we nonetheless are finalizing this needlessly complex system. In addition, the majority today makes ''targeted adjustments'' that further complicate matters. In some instances, these adjustments are at least requested by the commenters. In others, they are invented seemingly out of whole cloth.

The most troubling aspect of today's rule, though, is something new. The final rule includes changes to the definition of ''trading account'' that will significantly reduce the scope of financial instruments subject to the Volcker Rule's prohibition on proprietary trading. This change is described in the preamble to the final rule as avoiding having the trading account definition ''inappropriately scope in'' certain financial instruments, almost as if they were included in the proposal's scope by mistake. However, these financial instruments were within the scope of the 2013 rule, and they were within the scope of the proposal. Removing them now limits the scope of the Volcker rule so significantly that it no longer will provide meaningful constraints on speculative proprietary trading by banks. As such, I cannot vote for the rule.

Appendix 5—Dissenting Statement of CFTC Commissioner Dan M. Berkovitz

Congress adopted the statute commonly known as the ''Volcker Rule'' in the wake of the 2008 financial crisis to prevent banks that benefit from federal depository insurance or other government support from taking excessive risks that could lead to future taxpayer bailouts. The Volcker Rule prohibits proprietary trading and the owning of hedge funds and private equity funds by banks and their subsidiaries (''banking entities''), with certain exceptions and exemptions. In 2013 the Commission and other financial regulators adopted regulations to implement

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[7] Hand, L. *Is There a Common Will?* in The Spirit of Liberty: Papers and Addresses of Learned Hand 56 (I. Dilliard, 3d ed. 1960) (quoting from address before the American Law Institute in 1929).

[1] Opening Statement of Commissioner Rostin Behnam Before the Open Commission Meeting on June 4, 2018 (Jun. 4, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060418*.

[2] Jesse Hamilton and Yalman Onaran, ''Vocker the Man Blasts Volcker the Rule in Letter to Fed Chair,'' Bloomberg (Sep. 10, 2019), *https://www.bloomberg.com/news/articles/2019-09-10/volcker-the-man-blasts-volcker-the-rule-in-letter-to-fed-chair*.

the Volcker Rule. The final rule before the Commission today (''revised Volcker Rule'') substantially weakens these implementing regulations.

The revised Volcker Rule eliminates or reduces a variety of substantive standards in the current rule. The revised Volcker Rule will render enforcement of the rule difficult if not impossible by leaving implementation of significant requirements to the discretion of the banking entities, creating presumptions of compliance that would be nearly impossible to overcome, and eliminating numerous reporting requirements. The revised Volcker Rule also substantially reduces the bank trading activity covered by the rule. Finally, the revised Volcker Rule includes a number of changes and additions not contemplated or adequately discussed in the notice of proposed rulemaking (NPRM) in violation of the Administrative Procedure Act (''APA'') requirements for public notice and comment for rulemakings.

For these reasons, I dissent.

Weak Regulation and Enforceability Concerns

Nearly every amending provision of the revised Volcker Rule adopts the weakened provisions from the NPRM, further weakens the proposed changes, or makes new changes that weaken or eliminate existing requirements and standards. New presumptions of compliance favoring the banking entities, regulatory determinations left to the banking entities, and reductions in reporting requirements by the banking entities will make the revised Volcker Rule more difficult to enforce. The cumulative effect of this myriad of changes is a set of regulations that is ineffective and unenforceable. Although a single chip off a sculpture, by itself, may not create a noticeable blemish, widespread chiseling will disfigure the object. Such is the result here.

The ''trading account'' definition and related regulatory exclusions in the 2013 rule determine which financial transactions are subject to the restrictions on proprietary trading. Financial transactions of banking entities are subject to the Volcker regulations if they fall within certain ''prongs'' established in the trading account provision. The revised Volcker Rule rejects the ''accounting prong'' proposed in the NPRM and effectively jettisons the existing ''short-term intent prong'' for most entities.[1] In addition, there are a number of newly created outright exclusions of whole types of transactions and broadening of existing exclusions under the revised Volcker Rule.

FDIC Commissioner Martin Gruenberg provided an analysis of how these changes will significantly reduce the banking activity subject to Volcker oversight. ''By excluding these financial instruments from the Volcker Rule, the final rule . . . opens up vast new opportunity—hundreds of billions of dollars of financial instruments—at both the bank and bank holding company level, for speculative proprietary trading funded by the public safety net.'' [2]

The 2013 Volcker rules define the ''trading desk'' as the ''smallest discrete unit of organization'' that purchases and sells financial instruments. The revised Volcker Rule removes the quoted text, and instead provides four broad criteria for designating a trading desk. The rule then allows the banking entities to designate the trading desks for purposes of Volcker.

The new trading desk designation criteria appear to be broad enough that a ''trading desk'' could include whole business lines, divisions, or an entire swap dealer. The opportunities for undertaking greater amounts of proprietary trading expand significantly when the limits (which are set by the banking entities themselves), the desk-specific positions being hedged, and reporting requirements are applied to much larger trading portfolios. Because the revised Volcker Rule effectively presumes that these trading desk designations by the banking entities are valid, it will be more difficult for the applicable regulator to reign in proprietary trading undertaken by more expansively designated trading desks.

How much proprietary trading can occur under the market making exemption in the revised Volcker Rule will be determined by the risk limits set for each trading desk. The risk limits are to be established at the discretion of each banking entity and, as noted above, the scope of a trading desk also will be determined by the banking entity within broad criteria. ''Reasonably expected near-term demand'' (''RENTD'') of customers is included in the Volcker statute to establish the level of market making permissible. While the RENTD concept is still in the revised Volcker Rule, a presumption has been added that the RENTD levels set by each banking entity are correct.

Because these determinations will be established by the banking entity and presumed to be compliant, it will be difficult for any regulator to challenge them or take any enforcement action—even if a banking entity experiences large losses from proprietary trading—so long as the trading is found to be within the set limits.

These concerns about enforcement and oversight are exacerbated by the reduced metrics and other reporting, documentation, and compliance requirements. Numerous changes are made both as proposed and added on in this final rule. To name a few, stressed value at risk, daily risk factor sensitivities, and risk limit breaches need not be reported. In some cases, changes to reporting requirements make sense if experience shows a metric has little or no regulatory value. But most of these changes in the revised Volcker Rule are purportedly justified because they reduce the burden on banking entities and the cumulative effect on the ability of a regulator to monitor for compliance and potential significant issues is not addressed.

Logical Outgrowth Concerns

The revised Volcker Rule includes a number of new rules and amendments that were not mentioned or adequately described in the NPRM. The APA requires that a proposed rulemaking be published in the **Federal Register** and that interested persons be given an opportunity to comment.[3] A ''notice of proposed rulemaking must provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully.'' [4]

In comparing the revised Volcker Rule to the NPRM, there are a number of changes that were either not addressed in the NPRM or at best are based on comments received in response to general questions. For example, the NPRM included a proposal to replace the short-term intent prong with what is commonly referred to as the ''accounting prong.'' In the revised Volcker Rule, the accounting prong was rejected, but the short-term interest prong also is eliminated for most banking entities.[5] While replacing the short-term intent prong was discussed in the proposal, effectively eliminating the prong without a replacement was not proposed. Similarly the option for certain banking entities to now elect to comply with the market risk capital rule prong rather than the short-term intent prong was not discussed as an alternative. Nor was the replacement of the rebuttable presumption of proprietary trading for positions held shorter than 60 days with the opposite presumption that positions held longer than 60 days are not proprietary trading for purposes of the Volcker Rule. Agencies cannot ''pull a surprise switcheroo'' in the rulemaking process.[6]

Furthermore, the NPRM appears to not even contemplate excluding government bond assets and liabilities, mortgage servicing rights hedges, or financial instruments that are not trading assets or trading liabilities from counting as proprietary trading. Other changes, such as the elimination of incentive compensation limits, the matched derivatives transaction exclusion, and elimination of risk factor sensitivity metrics reporting appear to be based on general questions in the NPRM. In each case, no draft rule text or adequate discussion of such amendments was provided that would allow the public to have anticipated those amendments. Rather, many of these changes appear to be based on de novo comments made by banks or their trade organizations. ''[I]f the final rule 'substantially departs from the terms or substance of the proposed rule,' the notice is inadequate.'' [7]

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[1] While the short-term intent prong remains for a limited number of banks not subject to the market risk capital rules in banking regulations, compliance with the short-term intent prong is now optional if those banking entities instead elect to comply with the market risk capital rules for Volcker compliance.

[2] Statement by Martin J. Gruenberg, Member, FDIC Board of Directors, *The Volcker Rule* (Aug. 20, 2019) at 3, available at *https://www.fdic.gov/news/news/speeches/spaug2019b.pdf.*

[3] 5 U.S.C. 553(b) and (c).

[4] *Honeywell Int'l, Inc.* v. *EPA,* 372 F.3d 441, 445 (D.C. Cir. 2004) (internal quotation marks omitted).

[5] Firms subject to, or which elect to be subject to, the market risk capital rule prong are no longer subject to the short-term intent prong.

[6] *Environmental Integrity Project* v. *EPA,* 425 F.3d 992, 996 (D.C. Cir. 2005).

[7] *Chocolate Manufacturers Assoc. of the United States* v. *Block,* 755 F.2d 1098, 1105 (4th Cir. 1985) (*quoting Rowell* v. *Andrus,* 631 F.2d 699, 702 n.2 (10th Cir. 1980).

Conclusion

Self-regulation failed us in the early part of this century. Dodd-Frank, including the Volcker Rule, has helped this country rebuild a strong and better managed financial sector. To maintain a robust financial sector that benefits the American people, we must maintain strong standards and vigorous oversight. Otherwise, it is only a matter of time before the memory of the huge losses and resulting pressures for a taxpayer bailout fades and excessive risk taking comes home to roost. While the Dodd-Frank regulations may not be perfect and modest adjustments may be appropriate, the wholesale revision of regulations that greatly weaken the enforceability of those regulations such as we have before us today will, in the long run, weaken the financial sector and pose risks to the American public.

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