

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

---

**Date:** May 25, 2018  
**To:** Board of Governors  
**From:** Vice Chairman for Supervision Quarles  
**Subject:** Draft Proposed Revisions to Rules Implementing the Proprietary Trading and Hedge Fund and Private Equity Fund Restrictions of Section 13 of the Bank Holding Company Act

---

Attached are a memorandum to the Board and a draft Federal Register notice that would invite public comment on proposed revisions to the regulations implementing section 13 of the Bank Holding Company Act (the “Volcker Rule”). The proposal has been developed jointly with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (together, “the Agencies”).

In December 2013, the Agencies adopted a final rule (the “2013 final rule”) implementing the Volcker Rule. The Agencies have now had several years of experience implementing the 2013 final rule and, based on such experience, staffs of the Agencies have developed potential revisions to the regulation with the intent of (1) tailoring the requirements of the regulation to focus on entities with large trading operations; and (2) streamlining and simplifying regulatory requirements by eliminating or adjusting certain requirements and focusing on quantitative, bright-line rules where possible to provide clarity regarding prohibited and permissible activities. Specifically, the proposal would, among other changes:

- Create categories of banking entities based on the size of their trading assets and liabilities that would be used to tailor certain requirements of the rule;
- Clarify restrictions related to certain proprietary trading activities, revise and define terms relevant to proprietary trading activity, and reduce and tailor the criteria that apply when a banking entity seeks to rely on exemptions from the proprietary trading prohibitions;
- Clarify the prohibitions on a banking entity’s ability to acquire an ownership interest in, and maintain certain relationships with, a hedge fund or private equity fund; and
- Tailor compliance programs and amend the CEO attestation requirement

I have reviewed the attached materials and believe they are ready for the Board’s consideration.

Attachments



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

---

Date: May 25, 2018  
To: Board of Governors  
From: Staff<sup>1</sup>  
Subject: Draft Proposed Revisions to Rules Implementing the Proprietary Trading and Hedge Fund and Private Equity Fund Restrictions of Section 13 of the Bank Holding Company Act

---

**ACTION REQUESTED**

Staff seeks Board approval to invite public comment on the attached draft Federal Register notice (Attachment A, p. [●]) that proposes revisions to the regulation implementing section 13 (commonly known as the “Volcker Rule”) of the Bank Holding Company Act (“BHC Act”).<sup>2</sup> The proposal has been developed jointly with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (together, the “Agencies”). Staff also requests authority to make conforming changes (for example, to incorporate non-substantive changes requested by the other Agencies) as well as minor and technical changes (for example, to conform to Federal Register requests and correct non-substantive errors in the documents) to the attached draft Federal Register notice to prepare it for publication in the Federal Register.

**EXECUTIVE SUMMARY**

- In December 2013, the Agencies jointly issued a final rule (the “2013 final rule”) to implement the requirements of section 13 of the BHC Act. Section 13 generally prohibits a

---

<sup>1</sup> Messrs. Gibson and Lindo, and Mr. Tran, and Ms. Lorenc (Division of Supervision & Regulation); and Mr. Van Der Weide, Mss. Schaffer and Ahn, and Messrs. Frischmann and Walsh (Legal Division).

<sup>2</sup> Section 13 of the BHC Act was added by section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Pub. L. No. 111-203; see Dodd-Frank Act § 619; 12 U.S.C. 1851. A copy of section 13 of the BHC Act is attached as Attachment B, pp. 963-974.

banking entity<sup>3</sup> from engaging in proprietary trading<sup>4</sup> or acquiring or retaining an ownership interest in, or having certain relationships with, a hedge fund or private equity fund (“covered fund”). The 2013 final rule also requires firms with significant trading operations to report certain quantitative metrics related to their trading activities and requires banking entities to establish a Volcker Rule compliance program.

- Based on implementation experience since 2013, staffs at the Agencies believe that the rule can be simplified and tailored to reduce the costs of Volcker Rule compliance in a manner consistent with the statute and without negatively affecting the safety and soundness of banking entities.
- The proposal would broadly simplify and tailor the rule, as well as provide more clarity around permitted and restricted activities. Specifically, the proposal would, among other things:
  - Create categories of banking entities based on the size of their trading assets and liabilities, which would be used to tailor certain requirements of the rule;
  - Revise the term “trading account” in the rule by replacing the short-term intent-based prong with a new accounting-based prong;
  - Modify and tailor the eligibility requirements that apply when a banking entity seeks to rely on exemptions from the proprietary trading and covered fund prohibitions;
  - Create a presumption of compliance with the underwriting and market-making exemptions for certain trading desks within a banking entity whose underwriting or market-making activities fall within certain internal risk limits;
  - Modifies the requirements related to market making, underwriting, and hedging covered fund interests.

---

<sup>3</sup> The 2013 final rule, consistent with section 13 of the BHC Act, defines the term “banking entity” to include: (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; and (iv) any affiliate or subsidiary of any entity described in clauses (i), (ii), or (iii).

<sup>4</sup> For purposes of the Volcker Rule, proprietary trading generally means purchasing or selling financial instruments with the intent to profit from short-term price movements.

- Tailor compliance requirements based on a banking entity’s level of trading activity, including by creating a presumption of compliance with the rule for banking entities with limited trading assets and liabilities, and revise the scope of application of the existing chief executive officer (“CEO”) attestation requirement so that it applies only to firms that meet a specified threshold of trading activity; and,
- Simplify the trading activity information that certain banking entities are required to provide to the Agencies.
- The Economic Growth, Regulatory Relief, and Consumer Protection Act, which was enacted on May 24, 2018, exempts small banking entities with limited trading assets and liabilities from the statutory prohibitions on proprietary trading and covered fund activities and amends the statutory provisions related to the naming of covered funds. The attached Federal Register notice does not propose any changes that would implement these revisions, although it makes clear that the Agencies will not enforce the 2013 final rule in a manner inconsistent with the statutory amendments. Staff expects that these amendments to the statute will be addressed through a separate rulemaking process, as appropriate.

## **DISCUSSION**

Section 13 of the BHC Act prohibits any banking entity from engaging in proprietary trading as well as from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions. Since the issuance of the 2013 final rule implementing these statutory provisions, staff has identified opportunities, consistent with the statute, for revising the 2013 final rule to incorporate additional tailoring of its application based on the activities and risks of banking entities and to provide greater clarity about the activities that are prohibited and permitted. These proposed revisions also would improve staff’s ability to examine for, and make supervisory assessments regarding, a banking entity’s compliance with the statute and implementing regulations.

### **A. Tailoring by Size of Trading Assets and Liabilities**

To tailor application of the rule to better align with firms’ activities and risks, the proposal would establish three categories of banking entities based on trading activity. The first category would include banking entities that have “significant trading assets and liabilities,” which would be defined to mean consolidated gross trading assets and liabilities of at least \$10

billion. The proposal would require these banking entities to have a comprehensive compliance program that would be tailored to reflect the requirements of the statute. The second category would include banking entities that have “moderate trading assets and liabilities,” which would be defined to mean consolidated gross trading assets and liabilities less than \$10 billion but equal to or above \$1 billion. These firms would be subject to reduced compliance requirements that would be tailored in light of their relatively smaller and less complex trading activities. The third category would include banking entities that have “limited trading assets and liabilities,” which would be defined to mean consolidated gross trading assets and liabilities less than \$1 billion. These firms would have a rebuttable presumption of compliance with the rule.

Staff believes that it would be appropriate to subject banking entities with significant or moderate trading assets and liabilities to a tailored compliance program that reflects the level of their consolidated trading activities, while presuming compliance for those banking entities with limited trading assets and liabilities. There are currently approximately 40 firms that would be categorized as having significant or moderate trading activities, and those firms account for approximately 98 percent of the total U.S. trading activity by banking entities.

## **B. Proprietary Trading Restrictions**

### **1. *Revised Definition of Trading Account and Additional Exclusions***

**Definition of Trading Account.** The proprietary trading prohibitions, by statute, apply to positions taken as principal for the trading account of a banking entity. The statute defines “trading account” as 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), and any other such accounts as the Agencies may by rule determine. The 2013 final rule implemented the statutory definition of trading account with a three-pronged definition. The first prong is a “short-term intent prong” (subject to a rebuttable presumption), which includes any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of (a) short-term resale, (b) benefitting from short-term price movements, (c) realizing short term arbitrage profits, or (d) hedging any of the foregoing. The other two prongs are the “market risk capital prong” and the “dealer prong.” The “market risk capital prong” applies to the purchase or sale of financial instruments that are both market risk capital rule covered positions and trading positions. The “dealer prong” applies to the purchase or sale of financial instruments by a banking entity that is

licensed or registered, or required to be licensed or registered, as a dealer, swap dealer, or security-based swap dealer, with respect to transactions that would require the banking entity to be registered as such.

Banking entities have expressed the view that the short-term intent prong lacks clarity about whether particular purchases and sales of a financial instrument will be considered to be in a trading account. The Agencies, in the 2013 final rule, included a rebuttable presumption that the purchase or sale of a financial instrument is for the trading account if the banking entity holds the instrument for fewer than 60 days or substantially transfers the risk of the position within 60 days (the 60-day rebuttable presumption).<sup>5</sup>

The proposal would retain the market risk capital and dealer prongs<sup>6</sup> and replace the short-term intent prong with a prong based on the accounting treatment of a position (the “accounting prong”). Collectively, the market risk capital and dealer prongs and the new accounting prong would incorporate the scope of the statutory term “trading account” by defining the population of accounts that could be 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). The proposal would retain the market risk capital and dealer prongs because both provide clear lines and well-understood standards that are familiar to banking entities. The accounting prong would provide that the Volcker Rule trading account includes 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. The accounting prong would generally cover derivatives, trading securities, and available-for-sale securities. Staff also proposes to eliminate the 60-day rebuttable presumption.

Further, the proposal would add a presumption of compliance with the prohibition on proprietary trading for trading desks that are subject to only the accounting prong (not to the other two prongs) and operate in compliance with a prescribed profit and loss threshold. The purpose of this presumption of compliance would be to further reduce compliance costs for

---

<sup>5</sup> See § \_\_.3(b)(2) of the 2013 final rule.

<sup>6</sup> The market risk capital prong would be modified to include an account used by a foreign banking entity to purchase or sell one or more financial instruments, if the foreign banking entity is subject to a market risk capital framework imposed by its home country supervisor.

trading desks that do not consistently generate more than a threshold amount of absolute profit and loss. To avail itself of this presumption of compliance, a banking entity would determine on a daily basis the absolute value of net realized and unrealized gains or losses on each trading desk's portfolio of financial instruments. If this value exceeds \$25 million at any point over a 90-calendar-day period, then the banking entity would be required to demonstrate compliance with the statutory prohibitions and the regulation. The use of the absolute value of a trading desk's daily profit and loss is intended to ensure that a trading desk cannot avoid exceeding the threshold by offsetting significant net gains on one day with significant net losses on another day. While still subject to the statutory prohibition on proprietary trading and the applicable regulatory requirements, such trading desks that remain under the threshold would not have to demonstrate their compliance with the proprietary trading restrictions on an ongoing basis.

The proposal also would reserve authority for each Agency to determine on a case-by-case basis that a purchase or sale of one or more financial instruments either is or is not for the trading account, and, as a result, to require that any trading desk demonstrate compliance.

**Liquidity Management Exclusion.** The 2013 final 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, subject to certain requirements designed to ensure that the exclusion would not be used to engage in impermissible proprietary trading. This exclusion does not apply to foreign exchange derivative transactions used for liquidity management. Staff recognizes that banking entities often use foreign exchange forwards, foreign exchange swaps, and cross-currency swaps for liquidity management purposes. Accordingly, the proposal would expand the liquidity management exclusion to permit the purchase or sale of foreign exchange forwards, foreign exchange swaps, and physically-settled cross-currency swaps entered into by a banking entity for liquidity management purposes.

**Error Trades Exclusion.** From time to time, a banking entity may erroneously execute a purchase or sale of a financial instrument in the course of conducting permitted or excluded activity. To correct the error, a banking entity may need to engage in a subsequent transaction as principal. Staff is proposing a new exclusion from the definition of proprietary trading for trading errors and subsequent correcting transactions because these transactions generally lack the intent described in the statutory definition of "trading account" to profit from short-term price movements.

## *2. Permitted Underwriting and Market-Making Activities*

**Permitted underwriting and market-making activities.** Under the Volcker Rule, transactions in connection with underwriting and market-making activities, to the extent that such activities are designed not to exceed reasonably expected near term demand of clients, customers, or counterparties (“RENTD”), are exempted from the prohibition on proprietary trading.<sup>7</sup> Since the adoption of the 2013 final rule, staff has observed that the significant compliance requirements in the regulation applicable to demonstrating compliance with RENTD may unnecessarily constrain use of the underwriting and market-making exemptions.

Staff proposes to modify the requirements for both exemptions by providing a clearer way to measure and satisfy the statutory requirement that underwriting and market-making activity be designed not to exceed RENTD. In particular, the proposal would provide that the purchase or sale of a financial instrument by a banking entity is presumed not to exceed RENTD if the banking entity establishes underwriting and market-making internal risk 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.

The proposal also would tailor the compliance program requirements related to the underwriting and market-making exemptions. A banking entity with significant trading assets and liabilities would continue to be required to have a comprehensive internal compliance program as a condition for relying on these exemptions; however, the proposal would eliminate the specific compliance program requirements for banking entities that have moderate or limited trading assets and liabilities.

## *3. Permitted Risk-Mitigating Hedging Activities*

Section 13(d)(1)(C) of the BHC Act and the implementing regulation provide an exemption 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.

**Removal of certain hedging requirements for all banking entities.** Since adoption of the 2013 final rule, staff has become aware of practical difficulties in complying with the

---

<sup>7</sup> 12 U.S.C. 1851(d)(1)(B).

regulatory risk-mitigating hedging requirements. In particular, the correlation analysis requirement and the requirement that a banking entity show that a risk-mitigating hedging activity demonstrably reduces or otherwise significantly mitigates specific risks have made it difficult for banking entities to rely on this exemption. In addition, staff recognizes that in some circumstances, it may be difficult for banking entities to know with sufficient certainty that a potential hedging activity will continue to demonstrably reduce or significantly mitigate an identifiable risk after it is implemented. Therefore, staff proposes to remove the correlation analysis requirement and the “demonstrably reduces or otherwise significantly mitigates” specific risk requirement for risk-mitigating hedging activities.

**Reduced hedging requirements for banking entities that do not have significant trading assets and liabilities.** Staff is proposing to further tailor the requirements regarding hedging for banking entities without significant trading assets and liabilities. For these firms, staff is proposing to eliminate the requirements for a separate internal compliance program for risk-mitigating hedging; the limits on compensation arrangements for persons performing risk-mitigating activities; and the documentation requirements. In place of these requirements, the proposal would require that risk-mitigating hedging activities for these 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; 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.

**Reduced hedging documentation requirements for banking entities with significant trading assets and liabilities.** The 2013 final rule requires enhanced documentation for certain activities conducted under the risk-mitigating hedging exemption, including for hedges established to hedge aggregated positions across two or more desks. Staff believes that reducing the documentation requirement for common hedging activity undertaken in the normal course of business would make beneficial risk-mitigating activity more efficient and potentially improve the timeliness of important risk-mitigating hedging activity. Accordingly, the proposal would eliminate the enhanced documentation requirement for hedging activities that meets certain conditions. The proposal also would distinguish those financial instruments that are commonly used for hedging activities and conducted within appropriate limits from less common hedging

activity or unusual levels of hedging activity, which would still be subject to the enhanced documentation requirements.

#### ***4. Permitted Trading Activities of a Foreign Banking Entity***

Section 13(d)(1)(H) of the BHC Act permits certain foreign banking entities to engage in proprietary trading that occurs solely outside of the United States (the “foreign trading exemption”). The 2013 final rule includes several conditions on the availability of the foreign trading exemption. Specifically, the exemption is available only if: (i) the banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity 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 is not accounted for as principal by any branch or affiliate of the banking entity 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 by any branch or affiliate of the banking entity 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, generally, is not conducted with or through any U.S. entity.

The proposal would maintain requirements (i) through (iii), as described above. The proposal, however, would modify the first requirement to restrict only the relevant personnel engaged in the purchase or sale. Under the proposed approach, the focus of the first requirement would be on whether the banking entity that engages in the purchase or sale as principal (including any relevant personnel) is located in the United States. The proposal would also eliminate the requirements (iv) and (v) listed above. The proposed changes stem from feedback from foreign banking entities that the requirements under the 2013 final rule have unduly limited foreign banking entities’ ability to make use of the statutory exemption for proprietary trading and have resulted in an impact on foreign banking entities’ operations outside of the United States that is broader than necessary to achieve compliance with section 13 of the BHC Act. The proposed changes seek to reduce the impact of the 2013 final rule on foreign banking organizations’ operations outside of the United States by focusing on where the principal risk and actions of the purchase or sale take place.

## C. Covered Fund Activities and Investments

### 1. *Definition of Covered Fund*

In the 2013 final rule, the Agencies adopted a definition of “covered fund” that covers issuers of the type that would be investment companies but for section 3(c)(1) or 3(c)(7) of the Investment Company Act,<sup>8</sup> with a series of exclusions for certain specific types of issuers. While the proposal would not change the definition of “covered fund,” the proposal would seek comment on whether the definition should be further tailored and exclude certain additional types of funds.

### 2. *Activities Permitted in Connection with Organizing and Offering a Covered Fund*

**Underwriting and market making for a covered fund.** Section 13(d)(1)(B) of the BHC Act permits a banking entity to purchase and sell securities and other instruments in connection with certain underwriting or market making-related activities.<sup>9</sup> The 2013 final rule provides that the prohibition on ownership or sponsorship of a covered fund does not apply to a banking entity’s underwriting and market making-related activities involving a covered fund so long as a number of requirements are met.

For a covered fund that the banking entity does not organize or offer, the proposal would remove the requirement that the banking entity include in its aggregate fund limit and capital deduction the value of any ownership interests of the covered fund acquired or retained under the underwriting or market-making exemption. This proposed change would more closely align the requirements underwriting or market-making-related activities with respect to ownership interests in a covered fund with the requirements for these activities with respect to other

---

<sup>8</sup> Sections 3(c)(1) and 3(c)(7) of the Investment Company Act are exclusions commonly relied on by a wide variety of entities that would otherwise be covered by the broad definition of “investment company” contained in that Act. 12 U.S.C. 1851(h)(2). Sections 3(c)(1) and 3(c)(7) of the Investment Company Act, in relevant part, provide two exclusions from the definition of “investment company” for: (1) any issuer whose outstanding securities are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities (other than short-term paper); or (2) any issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are “qualified purchasers” as defined by section 2(a)(51) of the Investment Company Act, and which is not making and does not at that time propose to make a public offering of such securities. See 15 U.S.C. 80a-3(c)(1) and (c)(7).

<sup>9</sup> See 12 U.S.C. 1851(d)(1)(B).

financial instruments. The proposal would retain the requirements of the 2013 final rule associated with the per-fund limit, aggregate fund limit, and capital deduction with respect to underwriting and market making for a covered fund that the banking entity organizes and offers. In addition, the proposal would maintain the requirement that covered fund underwriting or market-making-related activities be conducted in accordance with the underwriting and market-making exclusions of the 2013 final rule (as modified by the proposal). These revised requirements are designed to facilitate a banking entity's underwriting and market-making-related activities for covered funds and to permit a banking entity to hold exposures consistent with the reasonably expected near term demand of clients, customers, and counterparties.

**Permitted risk-mitigating hedging activities.** Section 13(d)(1)(C) of the BHC Act provides an exemption for certain risk-mitigating hedging activities.<sup>10</sup> The 2013 final rule permitted only limited risk-mitigating hedging activities involving ownership interests in covered funds for hedging employee compensation arrangements. The proposal would allow a banking entity to acquire a covered fund interest as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.<sup>11</sup> In order to qualify for the hedging exemption, such activity would need to be designed to mitigate risk, which would be consistent with the safety and soundness of the banking entity. In addition, the hedging of employee compensation arrangements involving covered fund interests would remain unchanged from the 2013 final rule.

### ***3. Limitations on Relationships with a Covered Fund***

**Restrictions on covered transactions with certain funds.** Section 13(f) of the BHC Act generally prohibits a banking entity that serves as investment manager, investment adviser, or sponsor to a covered fund (or that organizes and offers a covered fund pursuant to section 13(d)(1)(G) of the BHC Act) from entering into a transaction with such covered fund that would be a covered transaction as defined in section 23A of the Federal Reserve Act ("FR Act").<sup>12</sup> In the 2013 final rule, the Agencies noted that "[s]ection 13(f) of the BHC Act does not incorporate

---

<sup>10</sup> See 12 U.S.C. 1851(d)(1)(C).

<sup>11</sup> A banking entity that seeks to use a covered fund interest to hedge on behalf of a customer would need to comply with all of the requirements of § \_\_.13(a).

<sup>12</sup> 12 U.S.C. 371c.

or reference the exemptions contained in section 23A of the FR Act or the Board’s Regulation W.”<sup>13</sup> Staff is requesting comment on certain aspects of the 2013 final rule’s approach to implementing the limitations on relationships with covered funds, including whether the Agencies should incorporate into the rule’s limitations on covered transactions the exemptions provided in section 23A of the FR Act and the Board’s Regulation W.<sup>14</sup>

#### 4. *Permitted Covered Fund Activities of a Foreign Banking Entity*

**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”). The 2013 final rule includes several conditions on the availability of the foreign fund exemption. Specifically, the exemption is available 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 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 is not accounted for as principal by any branch or affiliate of the banking entity 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 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 remove the financing requirement for the same reasons as described above for the foreign trading exemption. This proposed modification is intended to streamline the requirements of this exemption in order to improve implementation of the statutory exemption. The conditions to the foreign fund exemption, as modified by the proposal, are designed to require that the principal risks of covered fund investments and sponsorship by foreign banking entities permitted under the foreign fund exemption occur and remain solely outside of the United States.

---

<sup>13</sup> 79 FR at 5746.

<sup>14</sup> 12 U.S.C. 371c(d); see also 12 CFR 233.41-233.43.

**Offered for sale or sold to a resident of the United States.** One of the restrictions of the exemption for covered fund activities conducted by foreign banking entities outside the United States is the restriction that no ownership interest in the covered fund may be offered for sale or sold to a resident of the United States.<sup>15</sup> To implement this restriction, the 2013 final rule requires, as one condition of the foreign fund exemption, that “no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States” (the marketing restriction). The proposal provides that an ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of the marketing restriction only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States.<sup>16</sup>

##### *5. Treatment of Regulated Investment Companies and Certain Foreign Funds*

Since the adoption of the 2013 final rule, staff has received a number of requests for guidance regarding instances in which certain funds that are excluded from the covered fund definition remain subject to the Volcker Rule because they are considered banking entities.<sup>17</sup> Questions regarding the potential status of these funds as banking entities arise, in part, because of the interaction between the statute’s definition of the terms “banking entity” and the 2013 final rule’s definition of “covered fund.” Specifically, staffs of the Agencies have received numerous inquiries regarding this issue in connection with U.S. registered investment companies (“RICs”), foreign public funds (“FPFs”), and foreign excluded funds.<sup>18</sup> Staff has previously issued responses to frequently asked questions (“FAQs”) addressing the treatment of RICs and FPFs.<sup>19</sup> Moreover, the Federal banking agencies released a policy statement on July 21, 2017 (the “policy statement”), providing that the Federal banking agencies would not take action

---

<sup>15</sup> See 12 U.S.C. 1851(d)(1)(I).

<sup>16</sup> See FAQ #13, “SOTUS Covered Fund Exemption: Marketing Restriction,” available at the public websites of the Agencies.

<sup>17</sup> The 2013 final rule specifically excludes certain types of entities from the banking entity definition, including covered funds.

<sup>18</sup> Foreign excluded funds are certain foreign funds that are excluded from the definition of “covered fund” under the 2013 final rule with respect to a foreign banking entity.

<sup>19</sup> See FAQ #5, “Foreign Public Fund Seeding Vehicles,” available at the public websites of the Agencies; FAQ #14, “How does the final rule apply to a foreign public fund sponsored by a banking entity?” available at the public websites of the Agencies.

during the one-year period ending July 21, 2018, for foreign excluded funds that meet the conditions included in the policy statement. Under the proposal, the Agencies would request comment on all of these issues, and would extend the one-year no-action period described in the policy statement for another year (to July 21, 2019). The FAQs would also remain in effect during this time.

#### **D. Compliance Program—Tailored Requirements and Presumption of Compliance**

The 2013 final rule establishes compliance program requirements for all banking entities (with simplified requirements for smaller banking entities), as well as reporting and metrics collection requirements for certain banking entities based on their size and the nature of their activities. Staff believes these requirements can be more effectively tailored for all banking entities based on the size of each banking entity's trading assets and liabilities. Such tailoring would reduce burdens and uncertainty for smaller institutions, and would focus compliance program requirements on banking entities with the most significant and complex trading activities.

Specifically, staff proposes to apply 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 be subject to the six-pillar compliance program requirement,<sup>20</sup> the metrics reporting requirements, the underwriting and market-making compliance program requirements, the covered fund documentation requirements, and the CEO attestation requirement.
- **Banking entities with moderate trading assets and liabilities.** Banking entities with moderate trading assets and liabilities would be required to establish a simplified compliance program and comply with the CEO attestation requirement.
- **Banking entities with limited trading assets and liabilities.** Banking entities with limited trading assets and liabilities would be presumed to be in compliance with the Volcker Rule. These banking entities would not be required to establish a special Volcker Rule compliance program unless the appropriate Agency, based upon a review

---

<sup>20</sup> Like the 2013 final rule, the proposal would provide that a six-pillar compliance program must include written policies and procedures, internal controls, a management framework, independent testing and audit, training for relevant personnel, and recordkeeping requirements.

of the banking entity's activities, determines that the banking entity must establish a simplified compliance program.

Staff is also proposing to eliminate the enhanced minimum standards for compliance programs in the 2013 final rule. Further, the proposal would apply the covered fund documentation requirements set forth in the 2013 final rule only to banking entities with significant trading assets and liabilities.

#### **E. Reporting and Recordkeeping—Simplification of Requirements**

As provided in the preamble to the 2013 final rule, staff has assessed the metrics data for its effectiveness in monitoring covered trading activities for compliance with section 13 of the BHC Act and for its costs.<sup>21</sup> Staff has also considered whether all of the quantitative measurements are useful for all asset classes and markets, as well as for all the trading activities subject to the metrics requirement, or whether modifications to the existing metrics are appropriate.<sup>22</sup> As a result of this evaluation, staff is recommending certain amendments to Appendix A of the 2013 final rule to reduce compliance-related inefficiencies.

#### **F. Economic Impact**

The intended purpose of the proposed changes is to reduce the costs of Volcker Rule compliance while continuing the 2013 final rule's effectiveness and consistency with the statute. The proposal would include an in-depth description of each of the above-described changes and an analysis of how each change would be cost reducing. The proposal also would contain a robust request for comment on the costs and benefits of the proposed changes.

### **RECOMMENDATION**

Staff recommends that the Board approve publication of the attached Federal Register notice, which would invite comment for 60 days on the proposal to amend the regulations implementing the proprietary trading and covered fund restrictions of section 13 of the BHC Act. Staff also requests authority to make conforming changes as well as minor and technical changes to the draft proposal and Federal Register notice prior to publication (for example, to incorporate non-substantive changes requested by other Agencies, or to address any changes that may be requested by the Federal Register).

---

<sup>21</sup> See 79 FR 5772.

<sup>22</sup> Id.