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FEDERAL RESERVE SYSTEM
12 CFR Part 248
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FEDERAL DEPOSIT INSURANCE CORPORATION
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17 CFR Part 255
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COMMODITY FUTURES TRADING COMMISSION
17 CFR Part 75
RIN 3038-AE72

Revisions to 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 this release is January 1, 2020.

Compliance Date: Banking entities must comply with the final amendments by January 1, 2021. The 2013 rule will remain in effect until the compliance date, and a banking entity must continue to comply with the 2013 rule. 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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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 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;

¹ 12 U.S.C. 1851.

² *Id.*

- 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

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).

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

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.

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

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.

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 funds¹⁹ 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 compliance requirements based on new compliance tiers. The proposed rule would have applied the six-

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.

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

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.

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

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.

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

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.

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 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.

The final amendments will be effective on January 1, 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. 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

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).

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

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.

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 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

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

³⁹ *See* Public Citizen.

⁴⁰ *See* Volcker 2.0 Form Letter.

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

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

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).

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

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.*

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

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).

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 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

⁵⁵ See Data Boiler Technologies, LLC (Data Boiler).

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

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

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/bankinfo/reg/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.

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

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.

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

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.

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 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

⁷¹ *See* IIB. This commenter also proposed modifying the manner in which “banking entity” 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).

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

⁷⁶ *Id.*

⁷⁷ *See* “Control and Divestiture Proceedings,” 84 FR 21,634-666 (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

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

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).

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

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.

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 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

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

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.

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

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.*

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

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.

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-

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.

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 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

¹⁰⁵ *Id.*

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.

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

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 .

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

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.

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 certain types of instruments.¹¹⁹ The agencies support banking entities relying on current regulatory reporting

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.

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

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

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.

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

¹²⁴ See BPI.

¹²⁵ See final rule __.20(i).

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

¹²⁶ 12 U.S.C. 1851(h)(6).

¹²⁷ See 2013 rule § __.3(b)(1)(i).

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 connection with the activities of such business.¹³⁰

¹²⁸ See 2013 rule § __.3(b)(2).

¹²⁹ See 2013 rule § __.3(b)(1)(ii).

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

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

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.

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

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, Mortgage Bankers Association, and the Real Estate Roundtable (Real Estate Associations); State Street; Chatham Financial et al. (Chatham); Capital One et al.;

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

BPI; FSF; Goldman Sachs; SIFMA; Center for Capital Markets Competitiveness (CCMC); IIB; Credit Suisse; EBF; CREFC; 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.

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

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.

fair valuation of 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

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.

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

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.

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.

¹⁶⁹ See 83 FR at 33448.

¹⁷⁰ See proposed rule § __.3(c); 83 FR at 33449-51.

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

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.

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 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

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

¹⁸¹ See 83 FR at 33449.

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

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.

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

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).

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

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

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 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

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).

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).

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

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.

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

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.

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 the agencies have

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

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

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 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).

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

²¹⁵ See proposed rule § __. 3(b)(1)(ii); 83 FR at 33447.

²¹⁶ See IIB.

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

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.

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.

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.

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 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

²²² See 12 CFR 3.202; 12 CFR 217.202; 12 CFR 324.202 (defining “covered position”).

²²³ See 12 CFR part 217.

²²⁴ See, e.g., BPI; FSF; and SIFMA.

²²⁵ See e.g., BPI; FSF; and SIFMA.

long-term investment is part of the trading account. Another commenter requested that the agencies revise the dealer prong to ensure that derivative 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 derivative 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

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).

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 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

²²⁹ See final rule __.3(b)(1)(i), (ii).

²³⁰ See *infra* section IV.B.1.b.v.

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

²³¹ See 2013 rule § __.3(d)(3).

result of short-term price movements. Fourth, the plan must limit any 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,

²³² See 79 FR at 5555.

²³³ See 7 U.S.C. 1a(24) and 1a(25).

²³⁴ See proposed rule § __.3(e)(3).

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 in foreign 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

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.

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

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.

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

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.

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 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 swaps²⁵⁵ 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

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).

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

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.

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 that expose banking entities to substantial risk from fluctuations in market values,

²⁶⁰ See § __.3(d)(3).

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

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.

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

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.

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 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

²⁷² See Public Citizen.

²⁷³ See CAP.

²⁷⁴ Final rule § __.3(d)(10).

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.

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.

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

²⁷⁹ See Better Markets.

²⁸⁰ See 83 FR at 33462-64.

²⁸¹ See *id.* at 33462.

²⁸² *Id.*

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

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.*

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 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-

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.

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

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

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).

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

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.

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 risk³¹²; 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.

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).

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

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.

with a customer in connection with the 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

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.

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

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).

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.

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).

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 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

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.

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

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).

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 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

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.

³³⁷ See *id.*

³³⁸ See *id.*

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 institution³⁴⁴ and another said it is not necessary to introduce complexity into how banking entities organize their internal operations.³⁴⁵

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.

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

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).

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

³⁴⁸ Final rule § __.3(e)(13)(i)(A).

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

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’ 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

³⁵⁰ Compare 83 FR at 33453 with final rule § __.3(e)(13)(i)(B).

³⁵¹ See AFR.

³⁵² See JBA.

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

³⁵³ See 83 FR at 33454.

³⁵⁴ See, e.g., BB&T and CFA.

³⁵⁵ *Id.*

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 Activities³⁵⁹

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

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.

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.

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.

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:
 - The products, instruments, or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities;
 - Limits for each trading desk, based on the nature and amount of the trading 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;

- Internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and
- 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 limit³⁶⁷ 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

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.

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**

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.

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

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).

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 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

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).

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;

³⁸² 83 FR at 33438.

³⁸³ Proposed rule §___.4(a)(8)(i).

- (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

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

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.

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

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

³⁹¹ See, e.g., Credit Suisse Prop Letter; SIFMA; State Street; Real Estate Associations; and BOK.

³⁹² See SIFMA.

³⁹³ See State Street.

³⁹⁴ *Id.*

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 entities⁴⁰⁰ 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

³⁹⁵ See JBA.

³⁹⁶ See ABA.

³⁹⁷ See, e.g., Merkley; AFR; 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 Report; Bean; CAP; Public Citizen; Volcker Alliance; and Data Boiler.

⁴⁰¹ See, e.g., Bean and Volcker Alliance.

⁴⁰² See Better Markets.

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

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.

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 market maker.⁴¹¹ A commenter requested that the agencies revise

⁴⁰⁷ See FSF; State Street and SIFMA.

⁴⁰⁸ See Merkley; Volcker Alliance; and Data Boiler.

⁴⁰⁹ See Better Markets.

⁴¹⁰ See AFR.

⁴¹¹ See JBA.

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

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 Committee on Capital Markets 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.

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

⁴¹⁶ See BB&T.

⁴¹⁷ *Id.*

⁴¹⁸ *Id.*

⁴¹⁹ See JBA.

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 entities⁴²³ 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

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; GFMA; CRE Finance Council; ABA; SIFMA; IIB; BB&T; JBA; FSF; Credit Suisse; and Capital One et al.

⁴²³ See, e.g., Committee on Capital Markets; 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; CRE Finance Council; and CCMC.

⁴²⁶ See, e.g., BOK (stating that limit excesses do not, of themselves, show that an institution has changed its 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).

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

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., Committee on Capital Markets and BB&T.

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

⁴³³ See, e.g., FSF; JBA; and ABA.

⁴³⁴ See proposed rule § __.4(a)(8)(iv); proposed rule § __.4(b)(6)(iv).

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

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

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

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."

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

⁴⁴¹ 83 FR at 33459.

⁴⁴² See final rule, §__4(c)(1)(i).

(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

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

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 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.

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

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.

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

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).

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

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).

(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

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

⁴⁵³ See final rule §__.4(c)(3)(i).

⁴⁵⁴ The agencies note that the final rule requires that banking entities with significant trading assets 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).

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

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.

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

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.

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

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.

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

⁴⁶² See Better Markets.

⁴⁶³ *Id.*

⁴⁶⁴ *Id.*

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

⁴⁶⁵ *Id.*

⁴⁶⁶ *See* Data Boiler.

⁴⁶⁷ *See* Coalition of Derivatives End Users.

⁴⁶⁸ *Id.*

⁴⁶⁹ *See* CFA.

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

⁴⁷⁰ *Id.*

trading activities of banking entities that do not have significant trading activities comprise approximately six 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

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 position within a

(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

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.

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

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.

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

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).

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 procedures⁴⁷⁶ 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

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

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

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

⁴⁷⁷ See CCMC.

⁴⁷⁸ See 79 FR 5607.

⁴⁷⁹ See 79 FR 5606-5607.

⁴⁸⁰ See ISDA.

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

⁴⁸¹ 83 FR at 33464.

⁴⁸² *Id.*

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

⁴⁸³ *Id.*

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 (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-

⁴⁸⁴ *Id.*

⁴⁸⁵ *See, e.g.,* HSBC; JBA; and IIB.

⁴⁸⁶ *See* Data Boiler.

⁴⁸⁷ *See* IIB.

⁴⁸⁸ *See* HSBC and JBA.

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 desks⁴⁹¹ 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

⁴⁸⁹ See JBA.

⁴⁹⁰ See HSBC.

⁴⁹¹ See 79 FR at 5594.

⁴⁹² §__.4(b)(3).

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 rule⁴⁹⁵ and the amendments to the liquidity management exemption in the final rule⁴⁹⁶ 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 above⁴⁹⁷ 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

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.

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.

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.

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 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

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

⁵⁰⁰ See 2013 rule § __.5(b)(2).

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

⁵⁰¹ See 2013 rule § __.5(c).

⁵⁰² See 83 FR at 33465.

⁵⁰³ See 83 FR at 33465.

⁵⁰⁴ See *id.*

⁵⁰⁵ See *id.*

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.

⁵⁰⁶ See 83 FR at 33465.

⁵⁰⁷ 12 U.S.C. 1851(d)(1)(C).

⁵⁰⁸ See 83 FR at 33465.

⁵⁰⁹ See *id.*

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

⁵¹⁰ *See id.*

**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 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

⁵¹¹ See 83 FR at 33466.

⁵¹² *Id.*

⁵¹³ *Id.*

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,

⁵¹⁴ *Id.*

⁵¹⁵ *Id.*

⁵¹⁶ *Id.*

⁵¹⁷ *Id.*

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

⁵¹⁸ *Id.*

⁵¹⁹ *See* 83 FR at 33466-67.

⁵²⁰ *See* SIFMA.

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

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

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 I.

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.

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, 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

⁵²⁸ See Bean.

⁵²⁹ See Data Boiler.

⁵³⁰ See 83 FR at 33465.

⁵³¹ 12 U.S.C. 1851(d)(1)(C).

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

⁵³² See 83 FR at 33465.

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

⁵³³ *See id.*

⁵³⁴ 12 U.S.C. 1851(d)(1)(C).

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 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 Act⁵³⁵ 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

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.

to foreign banking entities where the purchase or sale is made pursuant to paragraph (9) 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).

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

⁵³⁸ *See* 2013 rule § __.6(e).

- (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

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.

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 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.

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

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

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.

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

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.

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 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.

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.

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.

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).

- 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

⁵⁵⁸ 2013 rule § __.12(a)(2)(iii).

⁵⁵⁹ 2013 rule § __.12(d).

⁵⁶⁰ *See* 2013 rule § __.11(c).

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.

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

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.

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 funds⁵⁶⁸ 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

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

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

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.

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

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.

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 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.

⁵⁷⁷ See Credit Suisse.

⁵⁷⁸ *Id.*

⁵⁷⁹ *Id.*

⁵⁸⁰ See Goldman Sachs.

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

⁵⁸¹ 12 U.S.C. 1851(d)(1)(C).

⁵⁸² See 83 FR at 33483-84.

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

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.

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.

⁵⁸⁹ See, e.g., AFR and Volcker Alliance.

⁵⁹⁰ See AFR.

⁵⁹¹ See Occupy the SEC.

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 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

⁵⁹² See, e.g., FSF; ISDA; and SIFMA.

⁵⁹³ See, e.g., final rule § __.3(d)(11).

- 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).

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).

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

⁵⁹⁶ See final rule § __.13(b)(4).

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

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.

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 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

⁶⁰¹ See 12 U.S.C. § 1851(d)(1)(I).

⁶⁰² See final rule § __.13(b)(1)(iii).

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

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.

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

⁶⁰⁹ See BVI.

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

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).

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 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

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).

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

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).

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

⁶²² See SIFMA.

⁶²³ See *id.*

⁶²⁴ See ABA.

⁶²⁵ See *id.*

⁶²⁶ See Occupy the SEC.

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

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).

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 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.

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.”

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.

- **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

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.

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 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

⁶³³ See Credit Suisse.

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

⁶³⁵ See Bean.

⁶³⁶ See AFR.

⁶³⁷ *Id.*

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.

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.

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; 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**

⁶⁴⁶ See JBA.

⁶⁴⁷ See BOK and Capital One et al.

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.

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.

⁶⁴⁹ 2013 rule __.20(f)(2).

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

⁶⁵⁰ See, e.g., BB&T and JBA.

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

⁶⁵¹ *See* B&F.

⁶⁵² *See* JBA.

⁶⁵³ *See* SIFMA.

⁶⁵⁴ *See* ABA.

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 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

⁶⁵⁵ See proposed rule § __.20(g)(2)(ii).

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

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).

Under the 2013 rule, a banking entity with substantial trading activity⁶⁵⁹ 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

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.

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 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

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.

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**.

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

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

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

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 discrepancies at a future date.

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

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 measurement is one trading day, but does not define “trading day”.

⁶⁶⁹ See, e.g., Credit Suisse; FSF; and JBA.

⁶⁷⁰ See JBA.

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 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

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.

⁶⁷³ In addition, the 2013 rule permits banking entities to optionally include trading under § ____.3(d), § ____.6(c), § ____.6(d), or § ____.6(e).

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 securities⁶⁷⁴ 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,

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.

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

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.

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.

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.

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 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

⁶⁹⁰ See, e.g., ABA; Credit Suisse, CCMR; FSF; IIB; JBA; and SIFMA.

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

⁶⁹¹ See, e.g., ABA; CCMR; and SIFMA.

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

⁶⁹² See, e.g., ABA; CCMR; Credit Suisse; Data Boiler; JBA; and SIFMA.

⁶⁹³ See SIFMA.

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 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

⁶⁹⁴ See, e.g., ABA; CCMR; Credit Suisse; Data Boiler; JBA; and SIFMA.

⁶⁹⁵ See SIFMA.

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

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.

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

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.

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.

⁷⁰⁵ The recordkeeping requirement in the final rule does not require that banking entities retain a copy of the Narrative Statement.

As noted above, commenters generally supported the proposal to define “applicability” in order to clarify that certain metrics are only applicable 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

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.

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

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;

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

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 C.F.R. part 3 subpart F; 12 C.F.R. part 217 subpart F; 12 C.F.R. part 324 subpart F.

⁷¹⁴ *See, e.g.*, FSF and Data Boiler.

⁷¹⁵ *See* JBA.

⁷¹⁶ *See* Goldman Sachs.

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 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

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.

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

⁷²¹ As under the 2013 rule, significant unexplained profit and loss must be escalated for further investigation and analysis under the final rule.

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

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.

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

⁷²⁵ See, e.g., GFMA; Goldman Sachs; and State Street.

⁷²⁶ See e.g., Credit Suisse.

instruments, the agencies are clarifying that futures positions 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

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

measure the number and value⁷²⁹ of all securities and derivatives transactions⁷³⁰ 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

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).

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 quantitative 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

⁷³² See, e.g., IIB and SIFMA.

⁷³³ See SIFMA.

⁷³⁴ See, e.g., Credit Suisse.

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 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

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.

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

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.

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 Act⁷³⁸ 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

⁷³⁸ Pub. L. 106-102, section 722, 113 Stat. 1338, 1471 (1999).

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 requirements⁷³⁹ 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

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.

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 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_taxonomy.

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 \$550 million or less and trust companies with total assets of \$38.5 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 886 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

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 \$550 million and \$38.5 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*.

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 \$550 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 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

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).

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 \$550 million.⁷⁴⁶ Generally, the FDIC considers a

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 \$550 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,

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

effective December 2, 2014). 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. Applying these SBA regulations, the FDIC uses 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.

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, 2,645 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.

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.

The FDIC has identified one of 2,645 small banking entities that are potentially affected by the final rule with generally modest compliance cost reductions. The FDIC believes this does not constitute significant economic impacts 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 2,645 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

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

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

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

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 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.

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

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).

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

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).

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 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

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*.

cost threshold. Accordingly, the OCC has not prepared the written statement described in section 202 of the UMRA.

F. SEC Economic Analysis

[Placeholder for SEC Economic Analysis.]

G. Congressional Review Act

[Placeholder for major rule determination.]

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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 nonmember banks, State savings associations, Trusts and trustees

12 CFR Part 351

Banks, banking, Capital, Compensation, Conflicts of interest, Credit, Derivatives, Government securities, Insurance, Insurance companies, Investments, Penalties, Reporting and recordkeeping requirements, Risk, Risk retention, 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

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)

1. 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

2. 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 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, 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* 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.*

(1) *Limited trading assets and liabilities* means, with respect to a banking entity, that:

(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 (3), 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 section 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.

(1) *Significant trading assets and liabilities means*, with respect to a banking entity, that:

(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 (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

3. Section 248.3 is amended by:

- a. Revising paragraph (b);
- b. Revising paragraph (d)(3) and adding paragraphs (d)(10), (11), (12), and (13);
- c. Redesignating paragraphs (e)(5) through (e)(13) as paragraphs (e)(6) through (e)(14);
- d. Adding new paragraph (e)(5); and
- e. Revising paragraph (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* 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)(i) A banking entity that is subject to paragraph (b)(1)(ii) in determining the scope of its trading account is not subject to paragraph (b)(1)(i).

(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.

(ii) Transition. 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 paragraph (d)(3) of this section; and

(vi) Is consistent with Board's supervisory requirements regarding liquidity management;

* * * * *

(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;

(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 subpart F of 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.

4. 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.

A banking entity with significant trading assets and liabilities may satisfy the requirements in (B) and (C) by complying with the requirements set forth below in paragraph (c) of this section;

(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 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 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.

A banking entity with significant trading assets and liabilities may satisfy the requirements in (C) and (D) by complying with the requirements set forth below in paragraph (c) of this section;

(iv) The compensation arrangements of persons performing the activities described in this paragraph (b) are designed not to reward or incentivize prohibited proprietary trading; and

(v) 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 § 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.

(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 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.

Such internal limits should take into account the liquidity, maturity, and depth of the market for the relevant types of securities.

(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 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.

Such internal limits should take into account the liquidity, maturity, and depth of the market for the relevant types of financial instruments.

(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 paragraphs (c)(1)(ii)(A) or (c)(1)(ii)(B) of this section, a banking entity shall maintain and make available to the Board 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 Board.

(ii) In the event of a breach or increase of any limit set pursuant to paragraphs (c)(1)(ii)(A) or (c)(1)(ii)(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:

(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.

(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.

5. Section 248.5 is revised 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.

6. Section 248.6 is amended by revising paragraph (e)(3); removing paragraphs (e)(4) and (e)(6); and redesignating paragraph (e)(5) as paragraph (e)(4) to read 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

7. Section 248.10 is amended by revising paragraph (c)(7)(ii) and paragraph (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;

* * * * *

8. 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) 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; 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. 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, 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); § 248.12(a)(2)(iii), and § 248.12(d) of this subpart.

§ 248.12 [Amended]

9. Section 248.12 is amended by:

- a. Removing paragraph (e)(2)(vii); and
- b. Redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

10. Section 248.13 is amended by revising paragraphs (a), (b)(3), and (c) and removing paragraph (b)(4)(iv) 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) 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) *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.

* * * * *

(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.

11. 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

12. Section 248.20 is amended by:

- a. Revising paragraph (a);
- b. Revising the introductory text of paragraph (b);
- c. Revising paragraph (c);
- d. Revising paragraph (d);
- e. Revising the introductory text of paragraph (e);
- f. Revising paragraph (f)(2); and
- g. Adding new paragraphs (g), (h), and (i).

The revisions 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 the Appendix to this part.* (1) A banking entity engaged in proprietary trading activity permitted under subpart B shall comply with the reporting requirements described in the Appendix, 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 the Appendix.

(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 the Appendix shall report the information required by the Appendix 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 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, 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 Subpart.

(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, 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 Subpart.

(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) 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) The Board will notify the banking entity of the decision in writing. The notice will include an explanation of the decision.

13. Remove Appendix A and Appendix B to Part 248 and add Appendix to Part 248—Reporting and Recordkeeping Requirements for Covered Trading Activities

Appendix 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 A 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 Board on the reporting schedule established in § 248.20 unless otherwise requested by 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 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 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

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.

“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.

² See § 248.2(h), (aa).