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DEPARTMENT OF TREASURY
Office of the Comptroller of the Currency
12 CFR Part 44
Docket No. OCC-2018-0010
RIN 1557-AE27

FEDERAL RESERVE SYSTEM
12 CFR Part 248
Docket No. R-1608
RIN 7100-AF 06

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 351
RIN 3064-AE67

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 255
Release no. BHCA-3; File no. S7-14-18
RIN 3235-AM10

COMMODITY FUTURES TRADING COMMISSION
17 CFR Part 75
RIN 3038-AE72

Proposed 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: Notice of proposed rulemaking.

SUMMARY: The OCC, Board, FDIC, SEC, and CFTC (individually, an "Agency," and collectively, the "Agencies") are requesting comment on a proposal that would amend the regulations implementing section 13 of the Bank Holding Company Act (BHC 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. The proposed amendments are intended to provide banking entities with clarity about what activities are prohibited and to improve supervision and implementation of section 13.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN FEDERAL REGISTER]**.

ADDRESSES: Interested parties are encouraged to submit written comments jointly to all of the Agencies. Commenters are encouraged to use the title "Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds" to facilitate the organization and distribution of comments among the Agencies. Commenters are also encouraged to identify the number of the specific question for comment to which they are responding. Comments should be directed to:

OCC: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments through the Federal eRulemaking Portal or e-mail, if possible. Please use the title "**Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds"** to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- ***Federal eRulemaking Portal—"regulations.gov":*** Go to *www.regulations.gov*. Enter "Docket ID **OCC-2018-0010**" in the Search Box and click "Search." Click on "Comment Now" to submit public comments.
- Click on the "Help" tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting public comments.

- **E-mail:** VolckerReg.Comments@occ.treas.gov.
- **Mail:** Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 400 7th Street, SW., suite 3E-218, Washington, DC 20219.
- **Hand Delivery/Courier:** 400 7th Street, SW., suite 3E-218, Washington, DC 20219.
- **Fax:** (571) 465-4326.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC-2018-0010" in your comment. In general, the OCC will enter all comments received into the docket and publish the comments on the Regulations.gov website without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this rulemaking action by any of the following methods:

- **Viewing Comments Electronically:** Go to *www.regulations.gov*. Enter "Docket ID OCC-2018-0010" in the Search box and click "Search." Click on "Open Docket Folder" on the right side of the screen and then "Comments." Comments can be filtered by clicking on "View All" and then using the filtering tools on the left side of the screen.
- Click on the "Help" tab on the Regulations.gov home page to get information on using Regulations.gov. Supporting materials may be viewed by clicking on "Open Docket

Folder" and then clicking on "Supporting Documents." The docket may be viewed after the close of the comment period in the same manner as during the comment period.

- **Viewing Comments Personally**: You may personally inspect and photocopy comments at the OCC, 400 7th Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700 or, for persons who are deaf or hearing impaired, TTY, (202) 649-5597. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

Board: You may submit comments, identified by Docket No. R-1608; RIN 7100-AF 06, by any of the following methods:

- **Agency website:** http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.
- **E-mail:** regs.comments@federalreserve.gov. Include docket and RIN numbers in the subject line of the message.
- **FAX:** (202) 452-3819 or (202) 452-3102.
- **Mail:** Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551. All public comments are available from the Board's website at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons or to remove sensitive personal information at the commenter's request. Public comments may also be viewed electronically or in paper form in Room 3515, 1801 K Street, NW. (between 18th and 19th Streets NW) Washington, DC 20006 between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN 3064-AE67 by any of the following methods:

- **Agency website:** http://www.FDIC.gov/regulations/laws/federal/propose.html. Follow instructions for submitting comments on the Agency website.
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- **Hand Delivered/Courier:** Comments may be hand-delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.
- **E-mail:** comments@FDIC.gov. Include the RIN 3064-AE67 on the subject line of the message.
- **Public Inspection:** All comments received must include the agency name and RIN 3064-AE67 for this rulemaking. All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/_, including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226 or by telephone at (877) 275-3342 or (703) 562-2200.

SEC: You may submit comments by the following methods:

Electronic Comments

- Use the SEC's Internet comment form (*http://www.sec.gov/rules/proposed.shtml)*; or Send an e-mail to rule-comments@sec.gov. Please include File Number S7-14-18 on the subject line.

Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-14-18. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The SEC will post all comments on the SEC's website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the SEC's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that the SEC does not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the SEC or SEC staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any materials will be made available on the SEC's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

CFTC: You may submit comments, identified by RIN 3038-AE72 and "Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," by any of the following methods:

- **Agency website**: https://comments.cftc.gov. Follow the instructions on the Web site for submitting comments.

- **Mail**: Send to Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, 1155 21st Street, NW., Washington, DC 20581.
- **Hand delivery/Courier**: Same as Mail above.

Please submit your comments using only one method. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to www.cftc.gov and the information you submit will be publicly available. If, however, you submit information that ordinarily is exempt from disclosure under the Freedom of Information Act, you may submit a petition for confidential treatment of the exempt information according to the procedures set forth in CFTC Regulation 145.9.1. The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from www.cftc.gov that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT:

OCC: Suzette Greco, Assistant Director; Tabitha Edgens, Senior Attorney; Mark O'Horo, Attorney, Securities and Corporate Practices Division (202) 649-5510; for persons who are deaf or hearing impaired, TTY, (202) 649-5597, Office of the Comptroller of the Currency, 400 7th Street, SW., Washington, DC 20219.

Board: Kevin Tran, Supervisory Financial Analyst, (202) 452-2309, Amy Lorenc, Financial Analyst, (202) 452-5293, David Lynch, Deputy Associate Director, (202) 452-2081, David McArthur, Senior Economist, (202) 452-2985, Division of Supervision and Regulation;

Flora Ahn, Senior Counsel, (202) 452-2317, Gregory Frischmann, Counsel, (202) 452-2803, or Kirin Walsh, Attorney, (202) 452-3058, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Bobby R. Bean, Associate Director, *bbean@fdic.gov*, Michael Spencer, Chief, Capital Markets Strategies Section, *michspencer@fdic.gov*, or Brian Cox, Capital Markets Policy Analyst, *brcox@fdic.gov*, Capital Markets Branch, (202) 898-6888; Michael B. Phillips, Counsel, *mphillips@fdic.gov*, Benjamin J. Klein, Counsel, *bklein@fdic.gov*, or Annmarie H. Boyd, Counsel, *aboyd@fdic.gov*, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

SEC: Andrew R. Bernstein (Senior Special Counsel), Sophia Colas (Attorney-Adviser), Sam Litz (Attorney-Adviser), Office of Derivatives Policy and Trading Practices, or Aaron Washington (Special Counsel), Elizabeth Sandoe (Senior Special Counsel), Carol McGee (Assistant Director), or Josephine J. Tao (Assistant Director), at (202) 551-5777, Division of Trading and Markets, and Nicholas Cordell, Matthew Cook, Aaron Gilbride (Branch Chief), Brian McLaughlin Johnson (Assistant Director), and Sara Cortes (Assistant Director), at (202) 551-6787 or *IArules@sec.gov*, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

CFTC: Erik Remmler, Deputy Director, (202) 418-7630, *eremmler@cftc.gov*; Cantrell Dumas, Special Counsel, (202) 418-5043, *cdumas@cftc.gov*; Jeffrey Hasterok, Data and Risk Analyst, (646) 746-9736, *jhasterok@cftc.gov*, Division of Swap Dealer and Intermediary Oversight; Mark Fajfar, Assistant General Counsel, (202) 418-6636, *mfajfar@cftc.gov*, Office of the General Counsel; Stephen Kane, Research Economist, (202) 418-5911, *skane@cftc.gov*,

Office of the Chief Economist; Commodity Futures Trading Commission, Three Lafayette Centre,1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was enacted on July 21, 2010.[1] Section 619 of the Dodd-Frank Act added a new section 13 to the BHC Act (codified at 12 U.S.C. 1851), also known as the Volcker Rule, that 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"), subject to certain exemptions.[2]

Section 13 of the BHC Act generally prohibits banking entities from engaging as principal in trading for the purpose of selling financial instruments in the near term or otherwise with the intent to resell in order to profit from short-term price movements.[3] Section 13(d)(1) expressly exempts from this prohibition, subject to conditions, certain activities, including:

- Trading in U.S. government, agency, and municipal obligations;
- Underwriting and market-making-related activities;
- Risk-mitigating hedging activities;
- Trading on behalf of customers;

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[2] *See* 12 U.S.C. 1851. Section 13 of the BHC Act does not prohibit a nonbank financial company supervised by the Board from engaging in proprietary trading, or from having the types of ownership interests in or relationships with a covered fund that a banking entity is prohibited or restricted from having under section 13 of the BHC Act. However, section 13 of the BHC Act provides that a nonbank financial company supervised by the Board would be subject to additional capital requirements, quantitative limits, or other restrictions if the company engages in certain proprietary trading or covered fund activities. *See* 12 U.S.C. 1851(a)(2) and (f)(4).

[3] *See* 12 U.S.C. 1851(a)(1)(A); 1851(h)(4) and (6).

- Trading for the general account of insurance companies; and
- Foreign trading by non-U.S. banking entities.[4]

Section 13 of the BHC Act also generally prohibits banking entities from acquiring or retaining an ownership interest in, or sponsoring, a hedge fund or private equity fund.[5] Section 13 contains several exemptions that permit banking entities to make limited investments in covered funds, subject to a number of restrictions designed to ensure that banking entities do not rescue investors in these funds from loss and are not themselves exposed to significant losses from investments or other relationships with these funds.[6]

Under the statute, authority for developing and adopting regulations to implement the prohibitions and restrictions of section 13 of the BHC Act is divided among the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (individually, an "Agency," and collectively, the "Agencies").[7] The Agencies issued a final rule implementing these provisions in December

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

[5] *See* 12 U.S.C. 1851(a)(1)(B).

[6] *See, e.g.*, 12 U.S.C. 1851(d)(1)(G).

[7] *See* 12 U.S.C. 1851(b)(2). Under section 13(b)(2)(B) of the BHC Act, rules implementing section 13's prohibitions and restrictions must be issued by: (i) the appropriate Federal banking agencies (*i.e.*, the Board, the OCC, and the FDIC), jointly, with respect to insured depository institutions; (ii) the Board, with respect to any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act, any nonbank financial company supervised by the Board, and any subsidiary of any of the foregoing (other than a subsidiary for which an appropriate Federal banking agency, the SEC, or the CFTC is the primary financial regulatory agency); (iii) the CFTC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act; and (iv) the SEC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act. *See id.*

2013 (the "2013 final rule").[8]

The Agencies have now had several years of experience implementing the 2013 final rule and believe that supervision and implementation of the 2013 final rule can be substantially improved. The Agencies acknowledge concerns that some parts of the 2013 final rule may be unclear and potentially difficult to implement in practice. Based on experience since adoption of the 2013 final rule, the Agencies have identified opportunities, consistent with the statute, for improving the rule, including further tailoring its application based on the activities and risks of banking entities. Accordingly, the Agencies are issuing this proposal (the "proposal" or "proposed amendments") to amend the 2013 final rule, in order to provide banking entities with greater clarity and certainty about what activities are prohibited and seek to improve effective allocation of compliance resources where possible. The Agencies also believe that the modifications proposed herein would improve the ability of the Agencies to examine for, and make supervisory assessments regarding, compliance relative to the statute and the implementing rules.

While section 13 of the BHC Act addresses certain risks related to proprietary trading and covered fund activities of banking entities, the Agencies note that the nature and business of banking entities involves other inherent risks, such as credit risk and general market risk. To that end, the Agencies have various tools, such as the regulatory capital rules of the Federal banking agencies and the comprehensive capital analysis and review framework of the Board, to require banking entities to manage the risks associated with their activities. The Agencies believe that the proposed changes to the 2013 final rule would be consistent with safety and soundness and

[8] *See* 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).

enable banking entities to implement appropriate risk management policies in light of the risks associated with the activities in which banking entities are permitted to engage under section 13.

The Agencies also note that the Economic Growth, Regulatory Relief, and Consumer Protection Act,[9] which was enacted on May 24, 2018, amends section 13 of the BHC Act by narrowing the definition of banking entity and revising the statutory provisions related to the naming of covered funds. The Agencies plan to address these statutory amendments through a separate rulemaking process; no changes have been proposed herein that would implement these amendments. The amendments took effect upon enactment, however, and in the interim between enactment and the adoption of implementing regulations, the Agencies will not enforce the 2013 final rule in a manner inconsistent with the amendments to section 13 of the BHC Act with respect to institutions excluded by the statute and with respect to the naming restrictions for covered funds. Additionally, the specific regulatory amendments proposed herein would not be inconsistent with the recent statutory amendments to section 13 of the BHC Act.

A. Rulemaking Framework

Section 13 of the BHC Act requires that implementation of its provisions occur in several stages. The first stage in implementing section 13 of the BHC Act was a study by the Financial Stability Oversight Council ("FSOC").[10] The FSOC study was issued on January 18, 2011, and

[9] Pub. L. 115-174, 132 Stat. 1296-1368 (2018).

[10] FSOC, Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (Jan. 18, 2011), *available at* http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20619%20study%20final%201%2018%2011%20rg.pdf (FSOC study); *see* 12 U.S.C. 1851(b)(1). Prior to publishing its study, the FSOC requested public comment on a number of issues to assist the FSOC in conducting its study. *See* Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds, 75 FR 61758 (Oct. 6, 2010). Approximately 8,000 comments were received from the public, including from members of Congress, trade associations, individual banking entities, consumer

included a detailed discussion of key issues and recommendations related to implementation of section 13 of the BHC Act.[11]

Following the FSOC study, and as required by section 13(b)(2) of the BHC Act, the Board, OCC, FDIC, and SEC in October 2011 invited the public to comment on a proposal implementing the requirements of section 13 of the BHC Act.[12] In February 2012, the CFTC issued a proposal that was substantially identical to the one proposed in October 2011 by the other four Agencies.[13] The Agencies received more than 600 unique comment letters, including from members of Congress; domestic and foreign banking entities and other financial services firms; trade groups representing banking, insurance, and the broader financial services industry; U.S. state and foreign governments; consumer and public interest groups; and individuals. The comments addressed all major sections of the 2011 proposal. To improve understanding of the issues raised by commenters, the staffs of the Agencies met with a number of these commenters to discuss issues relating to the 2011 proposal, and summaries of these meetings are available on each of the Agencies' public websites.[14] The CFTC staff also hosted a public roundtable on the 2011 proposal.[15] In formulating the 2013 final rule, the Agencies carefully reviewed all comments submitted in connection with the rulemaking and considered the suggestions and issues they raised in light of the statutory requirements as well as the FSOC study. In December 2013, the Agencies issued the 2013 final rule implementing section 13 of the BHC Act.

The Agencies are committed to revisiting and revising the rule as appropriate to improve its implementation. Since the adoption of the 2013 final rule, the Agencies have gained several

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groups, and individuals. As noted in the issuing release for the FSOC study, these comments were considered by the FSOC when drafting the FSOC study.

[11] *See id.*

years of experience implementing the 2013 final rule, and banking entities have had more than four years of experience implementing the 2013 final rule.[16]

In particular, the Agencies have received various communications from the public and other sources since adoption of the 2013 final rule and over the course of its implementation. These communications include written comments from members of Congress; domestic and foreign banking entities and other financial services firms; trade groups representing banking, insurance, and other firms within the broader financial services industry; U.S. state and foreign governments; consumer and public interest groups; and individuals. The U.S. Department of the Treasury also issued reports in June 2017 and October 2017, which contained recommendations

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[12] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 FR 68846 (Nov. 7, 2011) ("2011 proposal").

[13] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 77 FR 8331 (Feb. 14, 2012).

[14] *See* http://www.regulations.gov/#!docketDetail;D=OCC-2011-0014 (OCC); http://www.federalreserve.gov/newsevents/reform_systemic.htm (Board); http://www.fdic.gov/regulations/laws/federal/2011/11comAD85.html (FDIC); http://www.sec.gov/comments/s7-41-11/s74111.shtml (SEC); and http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_28_VolckerRule/index.htm (CFTC).

[15] *See* Commodity Futures Trading Commission, CFTC STAFF TO HOST A PUBLIC ROUNDTABLE TO DISCUSS THE PROPOSED VOLCKER RULE (May 24, 2012), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6263-12; transcript *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript053112.pdf.

[16] The 2013 final rule was published in the Federal Register on January 31, 2014, and became effective on April 1, 2014. Banking entities were required to fully conform their proprietary trading activities and their new covered fund investments and activities to the requirements of the 2013 final rule by the end of the conformance period, which the Board extended to July 21, 2015. The Board extended the conformance period for certain legacy covered fund activities until July 21, 2017. Upon application, banking entities also have an additional period to conform certain illiquid funds to the requirements of section 13 and implementing regulations.

regarding section 13 of the BHC Act and the implementing regulations.[17] In addition, the OCC issued a Request for Information ("OCC Notice for Comment") in August 2017 and received 87 unique comment letters and over 8,400 standardized letters regarding section 13 of the BHC Act and the implementing regulations.[18] Moreover, staffs of the Agencies have held numerous meetings with market participants to discuss the 2013 final rule and its implementation. Collectively, these sources of public feedback have provided the Agencies with a better understanding of the concerns and challenges surrounding implementation of the 2013 final rule.

Furthermore, the Agencies have collected nearly four years of quantitative data required under Appendix A of the 2013 final rule. The data collected in connection with the 2013 final rule, compliance efforts by banking entities, and the Agencies' experience in reviewing trading and investment activity under the 2013 final rule, have provided valuable insights into the effectiveness of the 2013 final rule. These insights highlighted areas in which the 2013 final rule may have resulted in ambiguity, overbroad application, or unduly complex compliance routines. With this proposal, and based on experience gained over the past few years, the Agencies seek to simplify and tailor the implementing regulations, where possible, in order to increase efficiency, reduce excess demands on available compliance capacities at banking entities, and allow banking

[17] *See* A Financial System That Creates Economic Opportunities, Banks and Credit Unions (June 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf and A Financial System that Creates Economic Opportunities, Capital Markets (October 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[18] *See* Notice Seeking Public Input on the Volcker Rule (August 2017), *available at* https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf. Corresponding comment letters are *available at* https://www.regulations.gov/docketBrowser?rpp=25&so=DESC&sb=commentDueDate&po=0&dct=PS&D=OCC-2017-0014. A summary of the comment letters is *available at* https://occ.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-notice-comment-summary.pdf.

entities to more efficiently provide services to clients, consistent with the requirements of the statute.[19]

B. Agency Coordination

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 . . . ."[20] The Agencies recognize that coordinating with respect to regulatory interpretations, examinations, supervision, and sharing of information is important to maintain consistent oversight, promote compliance with section 13 of the BHC Act and implementing regulations, and foster 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.

The Agencies request comment on coordination generally and the following specific questions:

Question 1. Would it be helpful for the Agencies to hold joint information gathering sessions with a banking entity that is supervised or regulated by more than one Agency? If not, why not, and, if so, what should the Agencies consider in arranging these joint sessions?

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[19] A number of Agency principals have suggested modifications to the 2013 final rule. *See* Randal K. Quarles, Mar. 5, 2018, *available at* https://www.federalreserve.gov/newsevents/speech/quarles20180305a.htm; Daniel K. Tarullo, Apr. 4, 2017, *available at* https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm; Martin J. Gruenberg, Nov. 14, 2017, *available at* https://www.fdic.gov/news/news/speeches/spnov1417.html.

[20] 12 U.S.C. 1851(b)(2)(B)(ii).

Question 2. In what ways could the Agencies improve the transparency of their implementation of section 13 of the BHC Act? What specific steps with respect to Agency coordination would banking entities find helpful to make compliance with section 13 and the implementing rules more efficient? What steps would commenters recommend with respect to coordination to better promote and protect the safety and soundness of banking entities and U.S. financial stability?

II. Overview of Proposal

A. General Approach

The proposal would adopt a revised risk-based approach that would rely on a set of clearly articulated standards for both prohibited and permitted activities and investments, consistent with the requirements of section 13 of the BHC Act. In formulating the proposal, the Agencies have attempted to simplify and tailor the 2013 final rule, as described further below, to allow banking entities to more efficiently provide services to clients.

The Agencies seek to address a number of targeted areas for potential revision in this proposal. First, the Agencies are proposing to tailor the application of the rule based on the size and scope of a banking entity's trading activities. In particular, the Agencies aim to further reduce compliance obligations for small and mid-sized firms that do not have large trading operations and therefore reduce costs and uncertainty faced by small and mid-size firms in complying with the final rule, relative to their amount of trading activity.[21] In the experience of the Agencies since adoption of the 2013 final rule, the costs and uncertainty faced by small and

[21] The Federal banking agencies issued guidance relating to compliance with the final rule for community banks in conjunction with the final rule in December of 2013. *See* The Volcker Rule: Community Bank Applicability, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20131210a4.pdf.

mid-sized firms in complying with the 2013 final rule can be disproportionately high relative to the amount of trading activity typically undertaken by these firms.

In addition to tailoring the application of the rule, the Agencies also seek to streamline and clarify for all banking entities certain definitions and requirements related to the proprietary trading prohibition and limitations on covered fund activities and investments. In particular, this proposal seeks to codify or otherwise addresses matters currently addressed by staff responses to Frequently Asked Questions ("FAQs").[22] Additionally, the Agencies are seeking in this proposal to reduce metrics reporting, recordkeeping, and compliance program requirements for all banking entities and expand tailoring to make the scale of compliance activity required by the rule commensurate with a banking entity's size and level of trading activity.

In tailoring these proposed changes to the 2013 final rule, the Agencies note the following statutory limitations to the permitted proprietary trading and covered fund activities,[23] which are incorporated in the 2013 final rule and have not been changed in the proposed rule. These statutory limitations provide that such permitted activities must not: (1) involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties; (2) result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or (3) pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.[24]

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[22] *See* https://www.occ.treas.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-rule-implementation-faqs.html (OCC);
https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm (Board);
https://www.fdic.gov/regulations/reform/volcker/faq.html (FDIC);
https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm (SEC);
https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_28_VolckerRule/index.htm (CFTC).

[23] *See* 12 U.S.C. 1851(d)(2).

[24] *See id.*

As a matter of structure, the proposed amendments would maintain the 2013 final rule's division into four subparts, and would maintain a metrics appendix while removing the 2013 final rule's second appendix regarding enhanced minimum standards for compliance programs, as follows:

- Subpart A of the 2013 final rule, as amended by the proposal, would describe the authority, scope, purpose, and relationship to other authorities of the rule and define terms used commonly throughout the rule;

- Subpart B of the 2013 final rule, as amended by the proposal, would prohibit proprietary trading, define terms relevant to covered trading activity, establish exemptions from the prohibition on proprietary trading and limitations on those exemptions, and require certain banking entities to report certain information with respect to their trading activities;

- Subpart C of the 2013 final rule, as amended by the proposal, would prohibit or restrict acquisition or retention of an ownership interest in, and certain relationships with, a covered fund; define terms relevant to covered fund activities and investments; and establish exemptions from the restrictions on covered fund activities and investments and limitations on those exemptions; and

- Subpart D of the 2013 final rule, as amended by the proposal, would generally require banking entities with significant trading assets and liabilities to establish a compliance program regarding section 13 of the BHC Act and the rule, including written policies and procedures, internal controls, a management framework, independent testing of the compliance program, training, and recordkeeping; establish metrics reporting requirements for banking entities with significant trading assets and liabilities, pursuant to the Appendix; provide tailored

compliance program requirements for banking entities without significant trading assets and liabilities, including a presumption of compliance for banking entities with limited trading assets and liabilities; and require certain larger banking entities to submit a chief executive officer ("CEO") attestation regarding the compliance program.

Given the complexities associated with the 2013 final rule, the Agencies request comment on the potential impact the proposal may have on banking entities and the activities in which they engage. The Agencies are interested in receiving comments regarding revisions described in the proposal relative to the 2013 final rule.[25] Additionally, the Agencies recognize that there are economic impacts that would potentially arise from the proposal and its implementation of section 13 of the BHC Act. The Agencies have provided an assessment of the expected impact of the proposed modifications contained in the proposal, and the Agencies request comment on all aspects of such impacts, including quantitative data, where possible. Specific requests for comment are included in the following sections.

B. Scope of Proposal

To better tailor the application of the rule, the proposal would establish three categories of banking entities based on their level of trading activity.[26] The first category would include banking entities with "significant trading assets and liabilities," defined as those banking entities that, together with their affiliates and subsidiaries, have trading assets and liabilities (excluding obligations of or guaranteed by the United States or any agency of the United States) equal to or

[25] This proposal contains certain proposed amendments to the 2013 final rule. The 2013 final rule would continue in effect where no change is made.

[26] The proposal would amend § __.2 of the 2013 final rule to include a new defined term for each of these categories. The Agencies are proposing to republish § __.2 in its entirety for clarity due to the renumbering of certain definitions. These proposed banking entity categories are discussed in further detail in Section II.G. of the Supplementary Information, below.

exceeding $10 billion. These banking entities, which generally have large trading operations, would be required to comply with the most extensive set of requirements under the proposal.

The second category would include banking entities with "moderate trading assets and liabilities," defined as those banking entities that do not have significant trading assets and liabilities or limited trading assets and liabilities. Banking entities with moderate trading assets and liabilities are those entities that, together with their affiliates and subsidiaries, have trading assets and liabilities (excluding obligations of or guaranteed by the United States or any agency of the United States) less than $10 billion, but above the threshold described below for banking entities with limited trading assets and liabilities.[27] These banking entities would be subject to reduced compliance requirements and a more tailored approach in light of their smaller and less complex trading activities.

The third category includes banking entities with "limited trading assets and liabilities," defined as those banking entities that have, together with their affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) less than $1 billion. This $1 billion threshold would be based on the worldwide trading assets and liabilities of a banking entity and all of its affiliates. With respect to a foreign banking organization ("FBO") and its subsidiaries, the $1 billion threshold would be based on worldwide consolidated trading assets and liabilities, and would not be limited to its combined U.S. operations.

The proposal would establish a presumption of compliance for all banking entities with limited trading assets and liabilities. Banking entities operating pursuant to this proposed presumption of compliance would have no obligation to demonstrate compliance with subparts B

[27] This category would also include banking entities with trading assets and liabilities of less than $1 billion for which the presumption of compliance described below has been rebutted.

and C of the proposal on an ongoing basis. If, however, upon examination or audit, the relevant Agency determines that the banking entity has engaged in proprietary trading or covered fund activities that are prohibited under subpart B or subpart C, such Agency may exercise its authority to rebut the presumption of compliance and require the banking entity to comply with the requirements of the rule applicable to banking entities that have moderate trading assets and liabilities. The purpose of this presumption of compliance would be to further reduce compliance costs for small and mid-size banks that either do not engage in the types of activities subject to section 13 of the BHC Act or engage in such activities only on a limited scale.

The proposal also includes a reservation of authority that would allow an Agency to require a banking entity with limited or moderate trading assets and liabilities to apply any of the more extensive requirements that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities, if the Agency determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion, warrants such treatment.

C. Proprietary Trading Restrictions

Subpart B of the 2013 final rule implements the statutory prohibition on proprietary trading and the various exemptions to this prohibition included in the statute. Section __.3 of the 2013 final rule contains the core prohibition on proprietary trading and defines a number of related terms. The proposal would make several changes to § __.3 of the 2013 final rule. Notably, the proposal would revise, in a manner consistent with the statute, the definition of "trading account" in order to increase clarity regarding the positions included in the definition.[28] The definition of "trading account" is a threshold definition that tells a banking entity whether

[28] Definitions used in the proposal would remain the same as in the 2013 final rule except as otherwise specified.

the purchase or sale of a financial instrument is subject to the restrictions and requirements of section 13 of the BHC Act and the 2013 final rule in the first instance.

In the 2013 final rule, the Agencies defined the statutory term "trading account" to include three prongs. The first prong 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 short-term price movements, realizing short-term arbitrage profits, or hedging another trading account position (the "short-term intent prong").[29] For purposes of this part of the definition, the 2013 final rule also contains a rebuttable presumption that the purchase or sale of a financial instrument by a banking entity is for the trading account if the banking entity holds the financial instrument for fewer than 60 days or substantially transfers the risk of the financial instrument within 60 days of purchase (or sale).[30] The second prong covers trading positions that are both covered positions and trading positions for purposes of the Federal banking agencies' market risk capital rules, as well as hedges of covered positions (the "market risk capital prong").[31] The third prong covers any account used by a banking entity that is a securities dealer, swap dealer, or security-based swap dealer that is licensed or registered, or required to be licensed or registered, as 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 (the "dealer prong").[32]

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[29] *See* 2013 final rule § __.3(b)(1)(i).

[30] *See* 2013 final rule § __.3(b)(2).

[31] *See* 2013 final rule § __.3(b)(1)(ii).

[32] *See* 2013 final rule § __.3(b)(1)(iii)(A). The dealer prong also includes positions entered into by a banking entity that 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. *See* 2013 final rule § __.3(b)(1)(iii)(B).

In the experience of the Agencies, determining whether or not positions fall into the short-term intent prong of the trading account definition has often proved unclear and subjective, and, consequently, may result in ambiguity or added costs and delays. For this reason, the proposal would remove the short-term intent prong from the 2013 final rule's definition of trading account and eliminate the associated rebuttable presumption, and would also modify the definition of trading account as described below to include other accounts described in the statutory definition of "trading account."[33]

The remaining two prongs of the trading account definition in the 2013 final rule, the market risk capital prong and the dealer prong, generally would remain unchanged because, in the experience of the Agencies, interpretation of both prongs has been relatively straightforward and clear in practice for most banking entities. The proposal would, however, modify the market risk capital prong to cover the trading positions of FBOs subject to similar requirements in the applicable foreign jurisdiction. The Agencies are proposing this modification for FBOs to take into account the different frameworks and supervisors FBOs may have in their home countries. Specifically, the proposal would modify the market risk capital prong to apply to FBOs that are subject to capital requirements under a market risk framework established by their respective home country supervisors, provided the market risk framework is consistent with the market risk framework published by the Basel Committee on Banking Supervision, as amended. The Agencies expect that this standard, similar to the current market risk capital prong referencing the U.S. market risk capital rules, would include trading account activities of FBOs consistent with the statutory trading account requirements. The Agencies believe the proposed

[33] 12 U.S.C. 1851(h)(6). As in the 2013 final rule, the Agencies note that the term "trading account" is a statutory concept and does not necessarily refer to an actual account. "Trading account" is simply nomenclature for the set of transactions that are subject to the prohibitions on proprietary trading under the 2013 final rule, including as it would be amended by the proposal.

approach would be an appropriate interpretation of the statutory trading account definition. The Agencies likewise believe that application of the market risk capital prong to FBOs as described herein would be relatively straightforward and clear in practice.

In addition, the Agencies are proposing two changes related to the trading account definition that are intended to replace the short-term intent prong. These changes include: (i) the addition of an accounting prong and (ii) a presumption of compliance with the prohibition on proprietary trading for trading desks that are not subject to the market risk capital prong or the dealer prong, based on a prescribed profit and loss threshold. Under the proposed accounting prong, a trading desk that buys or sells a financial instrument (as defined in the 2013 final rule and unchanged by the proposal) that is recorded at fair value on a recurring basis under applicable accounting standards would be doing so for the "trading account" of the banking entity.[34] Financial instruments that would be covered by the proposed accounting prong generally include, but are not limited to, derivatives, trading securities, and available-for-sale securities. For example, a security that is classified as "trading" under U.S. generally accepted accounting principles ("GAAP") would be included in the proposal's definition of "trading account" under the proposed approach because it is recorded at fair value.

The proposed presumption of compliance, which would apply at the trading desk level, would provide that each trading desk that purchases or sells financial instruments for a trading account pursuant to the accounting prong may calculate the net gain or loss on the trading desk's

[34] "Applicable accounting standards" is defined in the 2013 final rule, and the proposal would not make any change to this definition. "Applicable accounting standards" means U.S. generally accepted accounting principles or such other accounting standards applicable to a covered banking entity that the relevant Agency determines are appropriate, that the covered banking entity uses in the ordinary course of its business in preparing its consolidated financial statements. *See* 2013 final rule § __.10(d)(1). The proposal would move this defined term to § __.2, to accommodate its proposed usage outside of subpart C.

portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

If the sum of the absolute values of the daily net gain and loss figures for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk would be presumed to be in compliance with the prohibition on proprietary trading, and the banking entity would have no obligation to demonstrate that such trading desk's activity complies with the rule on an ongoing basis. If this calculation exceeds the $25 million threshold, the banking entity would have to demonstrate compliance with section 13 of the BHC Act and the implementing regulations, as described in more detail below. The Agencies are also proposing to include a reservation of authority to address any positions that may be incorrectly scoped into or out of the definition.

Section __.3 of the 2013 final rule also details various exclusions from the definition of proprietary trading for certain purchases and sales of financial instruments that generally do not involve the requisite short-term trading intent under the statute. The proposal would make several changes to these exclusions. First, the proposal would clarify and expand the scope of the financial instruments covered in the liquidity management exclusion. Second, it would add an exclusion from the definition of proprietary trading for transactions made to correct errors made in connection with customer-driven or other permissible transactions.

Section __.4 of the 2013 final rule implements the statutory exemptions for underwriting and market making-related activities. The proposal would make several changes to this section intended to improve the practical application of these exemptions. In particular, the proposal would establish a presumption that trading within internally set risk limits satisfies the

requirement that permitted underwriting and market making-related activities must be designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties ("RENTD"). The Agencies believe this presumption would allow for a clearer application of these exemptions, and would provide banking entities with more flexibility and certainty in conducting permissible underwriting and market making-related activities. In addition, the proposal would make the exemptions' compliance program requirements applicable only to banking entities with significant trading assets and liabilities.

The proposal would also modify the 2013 final rule's implementation of the statutory exemption for permitted risk-mitigating hedging activities in § __.5, by reducing restrictions on the eligibility of an activity to qualify as a permitted risk-mitigating hedging activity. For banking entities with moderate or limited trading assets and liabilities, the proposal would remove all requirements under the 2013 final rule except the requirement that hedging activity be designed to reduce or otherwise mitigate one or more specific, identifiable risks arising in connection with and related to one or more identified positions, contracts, or other holdings and that the hedging activity be recalibrated to maintain compliance with the rule. For banking entities with significant trading assets and liabilities, the proposal would maintain many of the 2013 final rule's requirements, including the requirement that the hedging activity be designed to reduce or otherwise mitigate one or more specific, identifiable risks. The proposal would, however, eliminate the current requirement that the hedging activity "demonstrably reduces" or otherwise "significantly mitigates" risk, reduce documentation requirements associated with risk-mitigating hedging transactions that are conducted by one desk to hedge positions at another desk with pre-approved types of instruments within pre-set hedging limits, and eliminate the

2013 final rule's correlation analysis requirement. These foregoing changes are intended to reduce costs and uncertainty and improve the utility of the hedging exemption.

Section __.6(e) of the proposal would remove certain requirements of the 2013 final rule implementing the statutory exemption for trading by a foreign banking entity that occurs solely outside of the United States. In particular, the proposal would modify the requirement that any personnel of the banking entity or any of its affiliates that arrange, negotiate, or execute such purchase or sale not be located in the United States. It also would (1) remove the requirement that no financing for the banking entity's purchase or sale be provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any state, and (2) eliminate certain limitations on a foreign banking entity's ability to enter into transactions with a U.S. counterparty.

The proposal would retain the other requirements of § ___.6(e) of the 2013 final rule, including the requirement that the banking entity engaging as principal in the purchase or sale (including relevant personnel) not be located in the United States or organized under the laws of the United States or of any State, that the banking entity not book a transaction to a U.S. affiliate or branch, and that 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. Taken as a whole, the proposed amendments to this exemption seek to reduce the impact of the 2013 final rule on foreign banking entities' operations outside of the United States by focusing on where the trading of these banking entities as principal occurs, where the trading decision is made, and whether the risk of the transaction is borne outside the United States.

D. Covered Fund Activities and Investments

Subpart C of the 2013 final rule implements the statutory prohibition on directly or indirectly acquiring and retaining an ownership interest in, or having certain relationships with, a covered fund, as well as the various exemptions to this prohibition included in the statute. Section __.10 of the 2013 final rule defines the scope of the prohibition on the acquisition and retention of ownership interests in, and certain relationships with, a covered fund, and provides the definition of "covered fund." The Agencies request comment on a number of potential modifications to this section.

Section __.11(c) of the 2013 final rule outlines the requirements that apply when a banking entity engages in underwriting or market making-related activities with respect to a covered fund. The proposal would modify these requirements with respect to covered fund ownership interests for third-party covered funds to generally allow for the same types of activities as are permitted for other financial instruments. The proposal would also make changes to § __.13(a) of the 2013 final rule to expand a banking entity's ability to engage in hedging activities involving an ownership interest in a covered fund.

E. Compliance Program Requirements

Subpart D of the 2013 final rule requires a banking entity engaged in covered trading activities or covered fund activities to develop and implement a program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading activities and covered fund activities and investments set forth in section 13 of the BHC Act and the 2013 final rule.

As in the 2013 final rule, the proposal would provide that a banking entity that does not engage in proprietary trading activities (other than trading in U.S. government or agency obligations, obligations of specified government-sponsored entities, and state and municipal

obligations) or covered fund activities and investments need only establish a compliance program prior to becoming engaged in such activities or making such investments. To further enhance compliance efficiencies, the proposal would reduce compliance requirements for most banking entities and expand tailoring of the requirements based on the banking entity categories previously described in this Supplementary Information section.

Under the proposal, a banking entity with significant trading assets and liabilities would be required to establish a six-pillar compliance programs commensurate with the size, scope, and complexity of its activities and business structure that meets six specific requirements already included in the 2013 final rule. These requirements include (1) 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; (2) a system of internal controls; (3) a management framework that, among other things, 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; (4) independent testing and audits; (5) training for certain personnel; and (6) recordkeeping requirements.[35] Certain additional documentation requirements for covered funds would also apply to banking entities with significant trading assets and liabilities. Because the proposal would eliminate Appendix B of the 2013 final rule, which requires large banking entities and banking entities engaged in significant trading activities to have a separate compliance program that complies with certain enhanced minimum standards, the proposed rule would essentially permit a banking entity with significant trading assets and liabilities to integrate compliance programs meeting these requirements into its existing compliance regime.

[35] *See infra* Supplementary Information, Part III.D.

Under the proposal, a banking entity with moderate trading assets and liabilities would be required to include in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act and the implementing rules as appropriate given the activities, size, scope, and complexity of the banking entity.

The proposal would also include in subpart D the specifications for the presumption of compliance noted above that would apply for banking entities with limited trading assets and liabilities.

The proposal would eliminate Appendix B of the 2013 final rule, which specifies enhanced minimum standards for compliance programs of large banking entities and banking entities engaged in significant trading activities. The proposal would, however, maintain the 2013 final rule's CEO attestation requirement, and would apply it to all banking entities with significant trading assets and liabilities and moderate trading assets and liabilities.

F. Metrics Reporting Requirement

As part of adopting the 2013 final rule, the Agencies committed to reviewing and assessing the quantitative measurements data ("metrics") for their effectiveness in monitoring covered trading activities for compliance with section 13 of the BHC Act and the implementing regulations. Since that time and as part of implementing the 2013 final rule, the Agencies have reviewed the metrics submitted by the banking entities and considered whether all of the quantitative measurements are useful for all asset classes and markets, as well as for all of the trading activities subject to the metrics requirement, or whether modifications are appropriate.

In the proposal, the Agencies aim to better align the effectiveness of the metrics data with its associated value in monitoring compliance. To that end, the proposal would streamline the metrics reporting and recordkeeping requirements by tailoring the requirements based on a banking entity's size and level of trading activity, completely eliminating particular metrics

based on experience working with the data, and adding a limited set of new metrics. The proposal also would provide certain firms with additional time to report metrics to the Agencies, beyond the current deadlines set forth in Appendix A of the 2013 final rule. The Agencies solicit comment regarding whether a single point of collection among the Agencies for metrics would be more effective.

G. Banking Entity Categorization and Tailoring

As noted, the proposal would define three different categories of banking entities based on thresholds of trading assets and liabilities, in order to improve compliance efficiencies for all banking entities generally and 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.

The first category would include any banking entity with significant trading assets and liabilities, defined under the proposal to mean a banking entity that, together with its affiliates and subsidiaries, has trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $10 billion.[36] The Agencies believe that this threshold would capture a significant portion of the trading assets and liabilities in the U.S. banking system, but would reduce burdens for smaller, less complex banking entities. The Agencies estimate that approximately 95 percent of the trading assets and liabilities in the U.S. banking system are

[36] *See* proposal § __.2(ff). With respect to a banking entity that is an FBO or a subsidiary of an FBO, the threshold would apply based on the trading assets and liabilities of the FBO's combined U.S. operations, including all subsidiaries, affiliates, branches, and agencies. This threshold would align with the threshold currently used under the 2013 final rule to determine whether a banking entity is subject to the metrics reporting requirements of Appendix A of the 2013 final rule.

currently held by those banking entities that would have significant trading assets and liabilities under the proposal. Under the proposal, the most stringent compliance requirements would apply to these banking entities, which generally have large trading operations. For example, as described in the relevant sections of this Supplementary Information section below, the proposal would require banking entities with significant trading assets and liabilities to comply with a greater set of requirements than other banking entities to meet the conditions of the exemptions for permitted underwriting and market making-related activities and risk-mitigating hedging activities. In addition, the proposal would require these banking entities to maintain a six-pillar compliance program (i.e., written policies and procedures, internal controls, management framework, independent testing, training, and records), commensurate with the size, scope, and complexity of their activities and business structure, which the banking entities could integrate into their existing compliance regime.

The second category would include any banking entity with moderate trading assets and liabilities, defined as a banking entity that does not have significant trading assets and liabilities or limited trading assets and liabilities (described below). These banking entities, together with their affiliates and subsidiaries, generally have trading assets and liabilities (excluding obligations of or guaranteed by the United States or any agency of the United States) of $1 billion or more but less than $10 billion. As with the threshold described above for firms with significant trading assets and liabilities, the Agencies believe that the proposed threshold for firms with moderate trading assets and liabilities would appropriately cover a significant percentage of trading activities in the United States. The Agencies estimate that approximately 98 percent of the trading assets and liabilities in the U.S. banking system are currently held by those firms that would have trading assets and liabilities of $1 billion or more, including firms

with both significant and moderate trading assets and liabilities. Relative to banking entities with significant trading assets and liabilities, banking entities with moderate trading assets and liabilities would be subject to reduced requirements and a tailored approach in light of their smaller portfolio of trading activity. For example, the proposal would require banking entities with moderate trading assets and liabilities to comply with a more tailored set of requirements under the underwriting, market-making, and risk-mitigating hedging exemptions, as compared to the requirements applicable to banking entities with significant trading assets and liabilities. In addition, these firms would be subject to a simplified compliance program requirement, which would allow the banking entity to comply with the applicable requirements by updating existing policies and procedures. The Agencies believe these changes could substantially reduce the costs of compliance for banking entities that do not have significant trading assets and liabilities.

The third category would include any banking entity with limited trading assets and liabilities, defined under the proposal to mean a banking entity that, together with its affiliates and subsidiaries, has trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion.[37] While entities with less than $1 billion in trading assets and

[37] The Agencies are proposing to adopt a different measure of trading assets and liabilities in determining whether a banking entity has less than $1 billion in trading assets and liabilities for purposes of tailoring the requirements of the rule described herein. Specifically, the proposed test would look at worldwide trading assets and liabilities of all banking entities, including foreign banking entities. By contrast, the test for whether a foreign banking entity has significant trading assets and liabilities provides that the banking entity need only include the trading assets and liabilities of its consolidated U.S. operations in this calculation. Banking entities with limited trading assets and liabilities under the proposal would be eligible for a presumption of compliance, but such a presumption may not be appropriate for large foreign banking entities

liabilities engage in some activities covered by section 13 of the BHC Act and the implementing rules, as noted above, these activities constitute a relatively small percentage of the trading assets and liabilities in the U.S. banking system. In light of the relatively small scale of activities engaged in by such firms, the Agencies are proposing to provide significant tailoring of requirements for such firms. Under the proposal, a banking entity with limited trading assets and liabilities would be presumed to be in compliance with subpart B and subpart C of the implementing regulations and would have no affirmative obligation to demonstrate compliance with subpart B and subpart C on an ongoing basis. If, upon examination or audit, the relevant Agency determines that the banking entity has engaged in covered trading activities or covered fund activities that are otherwise prohibited under subpart B or subpart C, such Agency may exercise its authority to rebut the presumption of compliance and require the banking entity to demonstrate compliance with the requirements of the rule applicable to a banking entity with moderate trading assets and liabilities. Additionally, as noted below, the relevant Agency would retain its authority to require a banking entity to apply any compliance requirements that would otherwise apply if the banking entity had moderate or significant trading assets and liabilities if such Agency determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion, does not warrant a presumption of compliance.

The purpose of this proposed presumed compliance provision would be to significantly reduce compliance program obligations for small and mid-size banking entities that do not engage on a large scale in activities subject to the proposal. Based on data from the December

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that have substantial worldwide trading assets and liabilities. Therefore, the Agencies have proposed to adopt one test that would apply to both domestic and foreign banking entities for purposes of the limited trading assets and liabilities threshold.

31, 2017, reporting period, all but approximately 40 top-tier banking entities would be eligible for presumed compliance.

The proposal would apply the 2013 final rule's CEO attestation requirement for all banking entities with significant or moderate trading assets and liabilities. Furthermore, all banking entities would remain subject to the covered fund provisions of the 2013 final rule, with some modifications described further below, including to the applicable compliance program requirements based on the trading assets and liabilities of the banking entity. As under the 2013 final rule, banking entities that do not engage in covered funds activities or proprietary trading would not be required to establish a compliance program unless or until prior to becoming engaged in such activities or making such investments.[38]

The proposal also includes a reservation of authority that would allow an Agency to require a banking entity with limited or moderate trading assets and liabilities to apply any of the more extensive requirements that would otherwise apply if the banking entity had moderate or significant trading assets and liabilities, if the Agency determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion, warrants such treatment.

The proposal seeks to tailor requirements based on a relatively simple, straightforward, and objective measure connected to the activities subject to section 13 of the BHC Act. Therefore, the Agencies are proposing thresholds that are based on the trading activities of a banking entity, and are considered on a consolidated basis with its affiliates and subsidiaries. In addition, many of the requirements that the proposal would apply on a tailored basis to banking entities based on these thresholds relate to the statutory prohibition on proprietary trading and the

[38] *See* § __.20(f) of the 2013 final rule.

associated exemptions, such as for permitted underwriting, market making, and risk-mitigating hedging activities. In general, this approach would seek to apply requirements commensurate with the size and complexity of a banking entity's trading activities.

Under this approach, banking entities with the largest trading activity (banking entities with significant trading assets and liabilities) would be subject to the most extensive requirements. These firms are currently subject to reporting requirements under Appendix A of the 2013 final rule due to the fact that they engage in the most trading activity subject to section 13 of the BHC Act and the implementing regulations.[39] Banking entities with moderate trading activities and liabilities would be subject to more tailored requirements, commensurate with the smaller scale of their trading activities. These firms are generally subject to the Federal banking agencies' market risk capital rules (like banking entities with significant trading assets and liabilities) and engage in some level of trading activity that is subject to the requirements of section 13 of the BHC Act, but not to the same degree as firms with significant trading assets and liabilities. Banking entities with limited trading assets and liabilities would be subject to significantly reduced requirements in recognition of the relatively small scale of covered activities in which they engage, and in order to reduce compliance costs associated with activities that are less likely to be relevant for these firms.

The Agencies request comment regarding all aspects of the proposed approach to tailoring application of the rule. In particular, the Agencies request comment on the following questions:

[39] As noted above, with respect to foreign banking entities, the proposal would measure whether a banking entity has significant trading assets and liabilities by reference to the aggregate assets of the foreign banking entity's U.S. operations, including its U.S. branches and agencies, rather than worldwide operations. This approach is intended to be consistent with the statute's focus on the risks posed by trading activities within the United States and also to address concerns regarding the level of burden for foreign banking entities with respect to their foreign operations.

Question 3. Would the general approach of the proposal to establish different requirements for banking entities based on thresholds of trading assets and liabilities be appropriate? Are the proposed thresholds appropriate or are there different thresholds that would be better suited and why? If so, what thresholds should be used and why? Would the proposed approach materially reduce compliance and other costs for banking entities that do not have significant trading activity? Would the proposed approach maintain sufficient measures to ensure compliance with the requirements of section 13 of the BHC Act? If not, what approach would work better? Would an approach based on the risk profile of the banking entity be more appropriate? Why or why not?

Question 4. The proposal seeks to establish a streamlined and comprehensive version of the rule for banking entities with significant trading assets and liabilities. Is the proposed definition of "significant trading assets and liabilities" appropriate? If not, what definition would be better and why? Would it be more appropriate to define a banking entity with significant trading assets and liabilities to include all banking entities subject to the Federal banking agencies' market risk capital rules? Why or why not?

Question 5. Are the proposed requirements for a banking entity with moderate trading assets and liabilities appropriate? Why or why not? If not, what requirements would be better and why? Should any requirements be added? Should any requirements be removed or modified? If so, please explain.

Question 6. The proposal contains a presumption of compliance for banking entities with limited trading assets and liabilities. Should the Agencies presume compliance for any other levels of activity? Why or why not? Are the proposed requirements for a banking entity with limited trading assets and liabilities appropriate? Should any requirements be added? If so,

please explain which requirements should be added and why. Do commenters believe this approach would work in practice? Would it reduce costs and increase certainty for small firms? If not, what approach would work better or be more appropriate and why? Is the proposed scope of banking entities that would be eligible for the presumption of compliance appropriately defined? Why or why not? Please explain. If not, what scope would be more appropriate?

Question 7. The proposal would tailor application of the regulation by categorizing a banking entity, together with its subsidiaries and affiliates, based on trading assets and liabilities. Should the Agencies consider further tailoring the application of the regulation by categorizing certain banking entities separately from their subsidiaries and affiliates? For example, should the Agencies consider further tailoring for a banking entity, including an SEC registered broker-dealer, that is an affiliate of a banking entity with significant trading assets and liabilities, but which generally operates on a basis that the banking entity believes is separate and independent from its affiliates and parent company for purposes relevant for compliance with the implementing regulations. Why or why not?

Question 8. How might a banking entity within a corporate group demonstrate that it has separate and independent operations from that of the consolidated holding company group (e.g., information barriers, separate corporate formalities and management; status as a registered securities dealer, investment adviser, or futures commission merchant; written policies and procedures designed to separate the activities of the affiliate from other banking entities)? Alternatively, could such entities be identified using certain quantitative measurements, such as by creating a specific dollar threshold of trading activity or by calculating a ratio comparing the entity's individual trading assets and liabilities to the gross trading assets and liabilities of the consolidated group? Why or why not? In addition, what standards could be applied to

distinguish such arrangements from corporate structures established to evade compliance requirements that would otherwise apply under section 13 of the BHC Act and the proposal? Please discuss, identify, and describe any conditions, functional barriers, or business practices that may be relevant. Commenters that suggest additional tailoring of the regulation for certain affiliates of large bank holding companies should suggest specific and detailed parameters for such a category. Commenters should also describe why they believe such parameters are appropriate and are designed to prevent substantial risk to the holding company, its affiliates, and the financial system.

Question 9. For purposes of determining the appropriate standard for compliance, the proposal would establish a threshold of $10 billion in trading assets and liabilities; banking entities with moderate trading assets and liabilities would be subject to a streamlined set of requirements under the proposal. If the Agencies were to apply additional tailoring for certain affiliates of banking entities with significant trading assets and liabilities, should such banking entities be subject to the same set of standards for compliance as those that are being proposed for banking entities with moderate trading assets and liabilities? Why or why not? Are there requirements that are not currently contemplated for banking entities with moderate trading assets and liabilities that nevertheless should apply, consistent with the statute? Please explain.

Question 10. What are the potential consequences if certain banking entities were to be subject to a more streamlined set of standards for compliance than their parent company and affiliates? What are the potential costs and benefits? Please explain. Are there ways in which a more tailored compliance regime for these types of banking entities could be crafted to mitigate any potential negative consequences associated with this approach, if any, consistent with the statute? Please explain.

Question 11. Could one or more aspects of the proposed rule incentivize banking entities to restructure their business operations to achieve a specific result relative to the rule, such as to facilitate compliance under the rule in a particular way or to avoid some or all of its requirements? If so, how? Please be as specific as possible.

III. Section by Section Summary of Proposal

A. Subpart A—Authority and Definitions

1. Section __.2: Definitions

a. Banking entity

The 2013 final rule, consistent with section 13 of the BHC Act, defines the term "banking entity" to include: (i) any insured depository institution; (ii) any company that controls an insured depository institution; (iii) any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978; and (iv) any affiliate or subsidiary of any entity described in clauses (i), (ii), or (iii).[40]

Under the BHC Act, an entity is generally considered an affiliate of an insured depository institution, and therefore a banking entity itself, if it controls, is controlled by, or is under common control with an insured depository institution. Under the BHC Act, a company controls another company if: (i) the company 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 company; (ii) the company controls in any manner the election of a majority of the directors of trustees of the other company; or (iii) the Board determines, after notice and

[40] *See* 2013 final rule § __.2(c). 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. *See* 2013 final rule § __.2(r).

opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the company.[41]

The 2013 final rule excludes covered funds and other types of entities from the definition of banking entity.[42] In the 2011 proposal, the Agencies reasoned that excluding covered funds from the definition of banking entity would "avoid application of section 13 of the BHC Act in a way that appears unintended by the statute and would create internal inconsistencies in the statutory scheme."[43]

Since the adoption of the 2013 final rule, the Agencies have received a number of requests for guidance regarding instances in which certain funds that are excluded from the covered fund definition are considered banking entities. This situation may occur as a result of the sponsoring banking entity having control over the fund, as defined under the BHC Act. A banking entity sponsoring a U.S. registered investment company ("RIC"), a foreign public fund

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

[42] A covered fund is not excluded from the banking entity definition if it is itself an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978. The 2013 final rule also excludes from the banking entity definition a portfolio company held under the authority contained in section 4(k)(4)(H) or (I) of the BHC Act, 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, so long as the portfolio company or portfolio concern is not itself an insured depository institution, a company that controls an insured depository institution, or a company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978. The definition also excludes 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 Act.

[43] *See* 2011 proposal, 76 FR at 68885. The Agencies proposed the clarification "because the definition of 'affiliate' and 'subsidiary' under the BHC Act is broad, and could include a covered fund that a banking entity has permissibly sponsored or made an investment in because, for example, the banking entity acts as general partner or managing member of the covered fund as part of its permitted sponsorship activities." *Id*. The Agencies observed that if "such a covered fund were considered a 'banking entity' for purposes of the proposed rule, the fund itself would become subject to all of the restrictions and limitations of section 13 of the BHC Act and the proposed rule, which would be inconsistent with the purpose and intent of the statute." *Id*.

("FPF"), or foreign excluded fund could be considered to control the fund by virtue of a 25 percent or greater investment in any class of voting securities during a seeding period or, for FPFs and foreign excluded funds, by virtue of corporate governance structures abroad such as where the fund's sponsor selects the majority of the fund's directors or trustees, or otherwise controls the fund for purposes of the BHC Act by contract or through a controlled corporate director.[44] Questions regarding these funds' potential status as banking entities arise, in part, because of the interaction between the statute's and the 2013 final rule's definitions of the terms "banking entity" and "covered fund."

In particular, following the adoption of the 2013 final rule, the staffs of the Agencies received numerous inquiries about this issue in connection with RICs and FPFs, which are excluded from the covered fund definition. The Agencies similarly received numerous inquiries regarding certain foreign funds offered and sold outside of the United States that are excluded from the covered fund definition with respect to a foreign banking entity (foreign excluded funds).

Sponsors of RICs, FPFs, and foreign excluded funds asserted that the treatment of these funds as banking entities would disrupt bona fide asset management activities involving funds that are not covered funds, which these sponsors argued would be inconsistent with section 13 of the BHC Act. These disruptions would arise because many funds' investment strategies involve proprietary trading prohibited by the 2013 final rule, and may also involve investments in covered funds. Sponsors of these funds further asserted that the permitted activities in the 2013 final rule also do not appear to be designed for funds, which by design invest in financial

[44] Corporate governance structures for RICs have not raised similar questions because the Board's regulations and orders have long recognized that a bank holding company may organize, sponsor, and manage a RIC, including by serving as investment adviser to the RIC, without controlling the RIC for purposes of the BHC Act. *See* 79 FR at 5676.

instruments for their own account. The 2013 final rule, for example, provides exemptions from the rule's proprietary trading restrictions for underwriting and market-making-related activities—exemptions for activities in which broker-dealers engage but that are not applicable to funds.

In addition, sponsors of RICs, FPFs, and foreign excluded funds asserted that restricting banking entities' bona fide investment management businesses in order to avoid treatment of their funds as banking entities would put bank-affiliated investment advisers at a competitive disadvantage relative to non-bank affiliated advisers engaged in the same activities without advancing the statutory purposes underlying section 13 of the BHC Act. Sponsors of FPFs and foreign excluded funds also have asserted that treating a foreign banking entity's foreign funds offered outside of the United States as banking entities themselves would be an inappropriate extraterritorial application of section 13 and the 2013 final rule and also unnecessary to reduce risks posed to banking entities and U.S. financial stability by proprietary trading activities and investments in or relationships with covered funds.

In response to these inquiries, the staffs of the Agencies issued responses to FAQs addressing the treatment of RICs and FPFs. The staffs observed in response to an FAQ that the preamble to the 2013 final rule recognized that a banking entity may own a significant portion of the shares of a RIC or FPF during a brief period during which the banking entity is testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes, and attempting to distribute the fund's shares (the so-called "seeding period").[45] The staffs therefore stated that they would not advise the Agencies to treat a RIC or FPF as a banking entity under the 2013 final rule solely on the basis that the RIC or FPF is established with a

[45] *See supra* note 22, FAQ 16.

limited seeding period, absent other evidence that the RIC or FPF was being used to evade section 13 and the 2013 final rule. The staffs stated their understanding that the seeding period for an entity that is a RIC or FPF may take some time. Recognizing that the length of a seeding period can vary, the staffs provided an example of three years, the maximum period of time expressly permitted for seeding a covered fund under the 2013 final rule, without setting any maximum prescribed period for a RIC or FPF seeding period. Accordingly, the staffs stated that they would neither advise the Agencies to treat a RIC or FPF as a banking entity solely on the basis of the level of ownership of the RIC or FPF by a banking entity during a seeding period, nor expect that a banking entity would submit an application to the Board to determine the length of the seeding period.[46]

The staffs also provided a response to an FAQ regarding FPFs.[47] In this response, staffs of the Agencies stated their understanding that, unlike in the case of RICs, sponsors of FPFs in some foreign jurisdictions select the majority of the fund's directors or trustees, or otherwise control the fund for purposes of the BHC Act by contract or through a controlled corporate director. These and other corporate governance structures abroad therefore had raised questions regarding whether FPFs that are sponsored and distributed outside the United States and in accordance with foreign laws are banking entities by virtue of their relationships with a banking entity. The staffs further observed that, by referring to characteristics common to publicly distributed foreign funds rather than requiring that FPFs organize themselves identically to RICs, the 2013 final rule recognized that foreign jurisdictions have established their own frameworks governing the details for the operation and distribution of FPFs. The staffs also observed that

[46] The staffs also made clear that this guidance was equally applicable to SEC-regulated business development companies.

[47] *See supra* note 22, FAQ 14.

§ __.12 of the 2013 final rule further provides that, for purposes of complying with the covered fund investment limits, a RIC, SEC-regulated business development company ("BDC"), or FPF will not be considered to be an affiliate of the banking entity so long as the banking entity meets the conditions set forth in that section.

Based on these considerations, the staffs stated that they would not advise that the activities and investments of an FPF that meet the requirements in § __.10(c)(1) and § __.12(b)(1) of the 2013 final rule be attributed to the banking entity for purposes of section 13 of the BHC Act or the 2013 final rule, where the banking entity, consistent with § __.12(b)(1) of the 2013 final rule, (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. The staffs further stated that they would not advise that the FPF be deemed a banking entity under the 2013 final rule solely by virtue of its relationship with the sponsoring banking entity, where these same conditions are met.

With respect to foreign excluded funds, the Federal banking agencies released a policy statement on July 21, 2017 (the "policy statement"), in response to concerns expressed by a number of foreign banking entities, foreign government officials, and other market participants about the possible unintended consequences and extraterritorial impact of section 13 and the 2013 final rule for these funds, which are excluded from the definition of "covered fund" in the 2013 final rule.[48] The policy statement provided that the staffs of the Agencies are considering

[48] Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf.

ways in which the 2013 final rule may be amended, or other appropriate action that may be taken, to address any unintended consequences of section 13 and the 2013 final rule for foreign excluded funds.

To provide additional time, the policy statement provides that the Federal banking agencies would not propose to take action during the one-year period ending July 21, 2018, against a foreign banking entity[49] based on attribution of the activities and investments of a qualifying foreign excluded fund (as defined below) to the foreign banking entity, 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 final rule, as if the qualifying foreign excluded fund were a covered fund. For purposes of the policy statement, a "qualifying foreign excluded fund" means, with respect to a foreign banking entity, an entity that:

(1) Is organized or established outside the United States and the ownership interests of which are offered and sold solely outside the United States;

(2) Would be a covered fund were the entity organized or established in the United States, or is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in financial instruments for resale or other disposition or otherwise trading in financial instruments;

[49] "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.

(3) Would not otherwise be a banking entity except by virtue of the foreign banking entity's acquisition or retention of an ownership interest in, or sponsorship of, the entity;

(4) Is established and operated as part of a bona fide asset management business; and

(5) Is not operated in a manner that enables the foreign banking entity to evade the requirements of section 13 or implementing regulations.

The Agencies are continuing to consider the issues raised by the interaction between the 2013 final rule's definitions of the terms "banking entity" and "covered fund," including the issues addressed by the Agencies' staffs and the Federal banking agencies discussed above. Accordingly, nothing in the proposal would modify the application of the staff FAQs discussed above, and the Agencies will not treat RICs or FPFs that meet the conditions included in the applicable staff FAQs as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs. In addition, to accommodate the pendency of the proposal, for an additional period of one year until July 21, 2019, the Agencies will not treat qualifying foreign excluded funds that meet the conditions included in the policy statement discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the policy statement. This additional time will allow the Agencies to benefit from public feedback in response to the requests for comment that follow. Specifically, the Agencies request comment on the following:

Question 12. Have commenters experienced disruptions to bona fide asset management activities involving RICs, FPFs, and foreign excluded funds as a result of the interaction between

the statute's and the 2013 final rule's definitions of the terms "banking entity" and "covered fund?" If so, what sorts of disruptions, and how have commenters addressed them?

Question 13. Has the guidance provided by the staffs of the Agencies' and the Federal banking agencies discussed above been effective in allowing banking entities to engage in asset management activities, consistent with the restrictions and requirements of section 13?

Question 14. Do commenters believe that there is uncertainty about the length of permissible seeding periods for RICs, FPFs, and SEC-regulated business development companies due to the Agencies' description of a seeding period with reference to the activities a banking entity undertakes while seeding a fund without specifying a maximum period of time? Would an approach that specified a particular period of time beyond which a seeding period cannot extend provide additional clarity? If so, what would be an appropriate time period? Should any specified time period be based on the period of time that typically is required for a RIC or FPF to develop a performance track record, recognizing that some additional time will also be needed to market the fund after developing the track record? How much time is necessary to develop a performance track record for a RIC or FPF to effectively market the fund to third-party investors and how does this vary based on the fund's strategy or other factors? If the Agencies did specify a fixed amount of time for seeding generally, should the Agencies also provide relief that permits a fund's seeding period to exceed this period of time, without the fund being considered a banking entity, subject to additional conditions, such as documentation of the business need for the sponsor's continued investment? Should such additional relief include the lengthening of the seeding period for such investments? Conversely, would the current approach of not prescribing a fixed period of time for a seeding period be more effective in providing

flexibility for funds that may need more time to develop a track record without having to specify a particular time period that will be appropriate for all funds?

Question 15. Are there other situations not addressed by the staffs' guidance for RICs and FPFs that may result in a banking entity sponsor's investment in the fund exceeding 25 percent, and that limit banking entities' ability to engage in asset management activities? For example, could a sponsor's investment exceed 25 percent as investors redeem in anticipation of a liquidation, causing the sponsor's investment to increase as a percentage of the fund's assets? Are there instances in which one or more large investors may redeem from a fund and, as a result, the sponsor may seek to temporarily invest in the fund for the benefit of remaining shareholders?

Question 16. Have foreign excluded funds been able to effectively rely on the policy statement to continue their asset management activities? Why or why not? Have foreign banking entities experienced any difficulties in complying with the condition in the policy statement that a foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, the qualifying foreign excluded fund would need to 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 final rule? Would the proposed changes in this proposal to § __.13(b) or any other provision of the 2013 final rule help foreign banking entities comply with the policy statement? Is the policy statement's definition of "qualifying foreign excluded fund" appropriate, or is it too narrow or too broad? Is further guidance needed with respect to any of the requirements in the definition of "qualifying foreign excluded fund"? For example, is it clear what constitutes a bona fide asset management

business? Has the policy statement posed any issues for foreign banking entities and their compliance programs?

Question 17. As stated above, the Agencies will not treat RICs or FPFs that meet the conditions included in the staff FAQs discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs. In addition, the Agencies are extending the application of the policy statement with respect to qualifying foreign excluded funds for an additional year to accommodate the pendency of the proposal. The Agencies are requesting comment on other approaches that the Agencies could take to address these issues, consistent with the requirements of section 13 of the BHC Act.

Question 18. Instead of, or in addition to, providing Agency guidance as discussed above, should the Agencies modify the 2013 final rule to address the issues raised by the interaction between the 2013 final rule's definitions of the terms "banking entity" and "covered fund," consistent with section 13 of the BHC Act, and if so, how? For example, should the Agencies modify the 2013 final rule to provide that a banking entity may elect to treat certain entities, such as a qualifying foreign excluded fund that meets the conditions of the policy statement, as covered funds, which would result in exclusion of these entities from the term "banking entity?" Would allowing a banking entity to invest in, sponsor, or have certain relationships with, the fund subject to the covered fund limitations in the 2013 final rule be an effective way for banking entities to address the issues raised? For example, a banking entity could sponsor and retain a de minimis investment in such a fund, subject to §§ __.11 and __.12 of the 2013 final rule. A foreign bank could invest in or sponsor such a fund so long as these

activities and investments occur solely outside the United States, subject to the limitations in § __.13(b) of the 2013 final rule.

Question 19. If a banking entity is willing to subject its activities and investments with respect to a non-covered fund to the covered fund limitations in section 13 and the 2013 final rule, which are designed to prevent banking entities from being exposed to significant losses from investments in or other relationships with covered funds, is there any reason that the ability to make this election should be limited to particular types of non-covered funds? Conversely, should a banking entity only be permitted to elect to treat as a covered fund a "qualifying foreign excluded fund," as defined in the policy statement issued by the Federal banking agencies?[50]

Question 20. If a banking entity elected to treat an entity as a covered fund, what potentially adverse effects could result and how should the Agencies address them? For example, if a foreign banking entity elected to treat a foreign excluded fund as a covered fund, would the application of the restrictions in § __.14 and the compliance obligations under § __.20 of the 2013 final rule involve the same or similar disruptions and extraterritorial application of section 13's restrictions that this approach would be designed to avoid? If so, what approach, consistent with the statute, should the Agencies take to address this issue? As discussed below in this Supplementary Information section, the Agencies are also requesting comment regarding potential changes in interpretation with respect to the 2013 final rule's implementation of section 13(f) of the BHC Act. How would any such modifications change any effects relating to an election to treat an entity as a covered fund?

Question 21. With respect to foreign excluded funds, to what extent would the proposed changes, and especially the proposed changes to §§ __.6(e) and __.13(b) of the 2013 final rule,

[50] *See supra* note 48.

adequately address the concerns raised regarding the treatment of foreign excluded funds as banking entities? If not, what additional modifications to these sections would enable such a fund to engage in proprietary trading or covered fund activity? Should the Agencies provide or modify exemptions under the 2013 final rule such that a qualifying foreign excluded fund could operate more effectively and efficiently, notwithstanding its status as a banking entity? If so, please explain how such an exemption would be consistent with the statute.

Question 22. Are there any other investment vehicles or entities that are treated as banking entities and for which commenters believe relief, consistent with the statute, would be appropriate? Which ones and why? What form of relief could be provided in a way consistent with the statute? For example, staffs of the Agencies have received inquiries regarding employees' securities companies ("ESCs"), which generally rely on an exemption from registration under the Investment Company Act provided by section 6(b) of that Act. These funds are controlled by their sponsors and, if those sponsors are banking entities, may themselves be treated as banking entities. Treating these ESCs as banking entities, however, may conflict with their stated investment objectives, which commonly are to invest in covered funds for the benefit of the employees of the sponsoring banking entity. Should an ESC be treated differently if its banking entity sponsor controls the ESC by virtue of corporate governance arrangements, which is a required condition of the exemptive relief under section 6(b) of the Investment Company Act that ESCs receive from the SEC, but does not acquire or retain any ownership interest in the ESC? If so, how should the Agencies consider residual or reversionary interests resulting from employees forfeiting their interests in the ESC? In pursuing their stated investment objectives on behalf of employees, do ESCs make these investment "as principal," as contemplated by section 13? To what extent do banking entities invest directly in ESCs? Are

there any other investment vehicles or entities, in pursuing their stated investment objectives on behalf of employees, that banking entities invest in "as principal" (e.g., nonqualified deferred compensation plans such as trusts modeled under IRS Revenue Procedure 92-64, commonly referred to as "rabbi trusts")? How should the Agencies consider these investment vehicles or entities with respect to section 13? Please include an explanation of how the commenters' preferred treatment of any investment vehicle would be consistent with section 13 of the BHC Act, including the statutory definition of "banking entity."

b. Limited Trading Assets and Liabilities

The proposed rule would add a definition of limited trading assets and liabilities. As described in greater detail in Part II.G above, limited trading assets and liabilities would be defined under the proposal as trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, does not exceed $1 billion.[51]

c. Moderate Trading Assets and Liabilities

The proposed rule would add a definition of moderate trading assets and liabilities. As described in greater detail in Part II.G above, moderate trading assets and liabilities would be defined under the proposal as trading assets and liabilities that are not significant trading assets and liabilities or limited trading assets and liabilities.

d. Significant Trading Assets and Liabilities

The proposed rule would add a definition of significant trading assets and liabilities. As described in greater detail in Part II.G above, significant trading assets and liabilities would be

[51] *See supra* note 37.

defined under the proposal as trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, equals or exceeds $10 billion.[52]

B. Subpart B—Proprietary Trading Restrictions

1. Section __.3 Prohibition on Proprietary Trading

Section 13 of the BHC Act generally prohibits banking entities from engaging in proprietary trading.[53] The statute defines "proprietary trading" 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, any of a number of financial instruments.[54] The statute defines "trading account" as any account used for acquiring or taking positions in financial instruments "principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the Agencies may, by rule, determine."[55]

a. Definition of Trading Account

The 2013 final rule, like the statute, defines proprietary trading as engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial

[52] *See supra* note 36.

[53] 12 U.S.C. 1851(a)(1)(A).

[54] 12 U.S.C. 1851(h)(4). The statutory proprietary trading definition applies to the purchase or sale, or the acquisition or disposition of, any security, derivative, contract of sale of a commodity for future delivery, option on any such security, derivative, or contract, or any other security or financial instrument that the Agencies by rule determine.

[55] 12 U.S.C. 1851(h)(6) (defining "trading account").

instruments.[56] The 2013 final rule implements the statutory definition of trading account with a three-pronged definition. The first prong (the "short-term intent prong") includes within the definition of trading account any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of (a) short-term resale, (b) benefitting from short-term price movements, (c) realizing short-term arbitrage profits, or (d) hedging any of the foregoing.[57] Banking entities and others have informed the Agencies that this prong of the definition imposes significant compliance costs and uncertainty because it requires determining the intent of each individual who purchases and sells a financial instrument.[58] In gaining experience implementing the 2013 final rule, the Agencies recognize that banking entities lack clarity about whether particular purchases and sales of a financial instrument are included under this prong of the trading account. The 2013 final rule includes a rebuttable presumption that the purchase or sale of a financial instrument is for the trading account under the short-term intent prong if the banking entity holds the financial instrument for fewer than 60 days or substantially transfers the risk of the position within 60 days (the "60-day rebuttable presumption").[59] If a banking entity sells or transfers the risk of a position within 60 days, it may rebut the presumption by demonstrating that it did not purchase or sell the financial instrument principally for short-term trading purposes. In the Agencies' experience, a broad range of transactions could trigger the 60-day rebuttable presumption. For example, the purchase of a security with a maturity (or remaining maturity) of fewer than 60 days to meet the regulatory requirements of a foreign government or to manage the banking entity's risks could trigger the 60-day rebuttable

[56] § __.3(a) of the proposed rule.

[57] § __.3(b)(1)(i) of the proposed rule.

[58] *See supra* note 18.

[59] § __.3(b)(2) of the proposed rule.

presumption because the banking entity holds the security for fewer than 60 days. In both cases, however, it is unlikely that the banking entity intended to purchase or sell the instrument principally for the purpose of short-term resale.

The other two prongs of the 2013 final rule's definition of trading account are the "market risk capital prong" and the "dealer prong." The "market risk capital prong" applies to the purchase or sale of financial instruments that are both market risk capital rule covered positions and trading positions.[60] The "dealer prong" applies to the purchase or sale of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, as a dealer, swap dealer, or security-based swap dealer, 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.[61]

The Agencies are proposing to revise the regulatory trading account definition to address concerns that the 2013 final rule's short-term intent prong requires banking entities and the Agencies to make subjective determinations with respect to each trade a banking entity conducts, and that the 60-day rebuttable presumption may scope in activities that do not involve the types of risks or transactions the statutory definition of proprietary trading appears to have been intended to cover. Specifically, the Agencies propose to retain the existing dealer prong and a modified version of the market risk capital prong, and to replace the 2013 final rule's short-term intent prong with a new third prong based on the accounting treatment of a position, in each case to implement the requirements of the statutory definition. The new prong would provide that

[60] § __.3(b)(1)(ii) of the proposed rule.

[61] § __.3(b)(1)(iii)(A) of the proposed rule. The dealer prong also includes positions entered into by a banking entity that 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. *See* 2013 final rule § __.3(b)(1)(iii)(B).

"trading account" means any account used by a banking entity to purchase or sell one or more financial instruments that is recorded at fair value on a recurring basis under applicable accounting standards (the "accounting prong"). The Agencies also propose to eliminate the 60-day rebuttable presumption in the 2013 final rule.

The Agencies further propose to add a presumption of compliance with the prohibition on proprietary trading for trading desks that do not purchase or sell financial instruments subject to the market risk capital prong or the dealer prong and operate under a prescribed profit and loss threshold.[62] While still subject to the prohibition on proprietary trading under section 13 of the BHC Act and the applicable regulatory requirements, such eligible trading desks that remain under the threshold would not have to demonstrate their compliance with subpart B on an ongoing basis, as discussed below. Notwithstanding this regulatory presumption of compliance, the Agencies would reserve authority to determine on a case-by-case basis that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account, and, as a result, may require that a trading desk demonstrate compliance with subpart B on an ongoing basis with respect to a financial instrument.

Under the proposed approach, "trading account" would continue to include any account used by a banking entity to (1) purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule, or (2) purchase or sell one or more financial instruments for any purpose, if the banking entity is licensed or registered, or

[62] In addition, the Agencies are proposing to adopt a presumption of compliance for banking entities with limited trading activities. *See* § __.20(g) of the proposed rule.

required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, if the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such[63] (or if the banking entity is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, if the instrument is purchased or sold in connection with the activities of such business).[64] The Agencies are proposing to retain these prongs because both prongs provide clear lines and well-understood standards for purposes of determining whether or not a purchase or sale of a financial instrument is in the trading account. The Agencies also propose to adapt the market risk capital prong to apply to the activities of FBOs in order to take into account the different regulatory frameworks and supervisors that FBOs may have in their home countries. Specifically, the Agencies propose to include within the market risk capital prong, with respect to 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, any account used by the banking entity to purchase or sell one or more financial instruments that are subject to 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, as amended from time to time.

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[63] An insured depository institution may be registered as, among other things, a swap dealer and a security-based swap dealer, but only the swap and security-based dealing activities that require it to be so registered are included in the trading account by virtue of the dealer prong. 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 would be included in the trading account only if the purchase or sale of the financial instrument falls within the market risk capital trading account prong under § __.3(b)(1) or the accounting prong under § __.3(b)(3) of the proposed rule. *See* 79 FR at 5549, note 135.

[64] *See* § __.3(b)(2) of the proposed rule.

b. Trading account – Accounting Prong

The proposal's definition of "trading account" for purposes of section 13 of the BHC Act would replace the short-term intent prong in the 2013 final rule with a new prong based on accounting treatment, by reference to whether a financial instrument (as defined in the 2013 final rule and unchanged by the proposal) is recorded at fair value on a recurring basis under applicable accounting standards. Such instruments generally include, but are not limited to, derivatives, trading securities, and available-for-sale securities. For example, for a banking entity that uses GAAP, a security that is classified as "trading" under GAAP would be included in the proposal's definition of "trading account" under this approach because it is recorded at fair value. "Fair value" refers to a measurement basis of accounting, and is defined under GAAP as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.[65]

The proposal's inclusion of this prong in the definition of "trading account" is intended to give greater certainty and clarity to banking entities about what financial instruments would be included in the trading account, because banking entities should know which instruments are recorded at fair value on their balance sheets. This modification of the rule's definition of trading account would include other accounts that may be used by banking entities for the purpose described in the statutory definition of "trading account."[66] The proposal is intended to address concerns that the statutory definition of trading account may be read to contemplate an inquiry into the subjective intent underlying a trade.[67] The proposal would therefore adopt the accounting prong as an objective means of ensuring that such positions entered into by banking

[65] *See* Accounting Standards Codification (ASC) 820-10-20 and International Financial Reporting Standard (IFRS) 13.9.

[66] 12 U.S.C. 1851(h)(6).

[67] *See id.*

entities principally for the purpose of selling in the near term, or with the intent to resell in order to profit from short-term price movements, are incorporated in the definition of trading account. For entities that are not subject to the market-risk capital prong or the dealer prong, the accounting prong would therefore be the sole avenue by which such banking entities would become subject to the requirements in subpart B of the proposed rule.

Question 23. Should the Agencies adopt the proposed new accounting prong and remove the short-term intent prong? Why or why not? Does using such a prong provide sufficient clarity regarding which financial instruments are included in the trading account for purposes of the proposal? Are there differences in the application of IFRS and GAAP that the Agencies should consider? What are they and how would they impact the scope of the proposed accounting prong?

Question 24. Is using the accounting prong appropriate considering the fact that entities may have discretion over whether certain financial instruments are recorded at fair value (and therefore subject to the restrictions in section 13 of the BHC Act)? Could the proposed accounting prong incentivize banking entities to modify their accounting treatment with respect to certain financial instruments in order to evade the prohibition on proprietary trading? Why or why not? If so, could those effects have an impact on the banking entity's accounting practices?

Question 25. Should the Agencies include all financial instruments that are recorded at fair value on a banking entity's balance sheet as part of the proposed accounting prong? Why or why not? Would such a definition be overly broad? If so, why and how should the definition be narrowed, consistent with the statute? Would such a definition be too narrow and exclude financial instruments that should be included? If so, should the Agencies apply a different approach? Why or why not?

Question 26. Is the proposal's inclusion of available-for-sale securities under the proposed accounting prong appropriate? Why or why not?

Question 27. The proposed accounting prong would include all derivatives in the proposed accounting prong since derivatives are required to be recorded at fair value. Is this appropriate? Why or why not?

Question 28. Should the scope of the proposed accounting prong be further specified? In particular, should practical expedients to fair value measurements permitted under applicable accounting standards be included in the "trading account" definition (e.g., equity securities without readily determinable fair value under ASC 321 or investments using the net asset value ("NAV") practical expedient under ASC 820)? Why or why not? Are there other relevant examples that cause concern?

Question 29. Is there a better approach to defining "trading account" for purposes of section 13 of the BHC Act, consistent with the statute? If so, please explain.

Question 30. Would the short-term intent prong in the 2013 final rule be preferable to the proposed accounting prong? Why or why not? Should the Agencies rely on a potentially objective measure, such as the accounting treatment of a financial instrument, to implement the definition of "trading account" in section 13(h)(6), which includes any account used for acquiring or taking positions in certain 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"?[68]

[68] 12 U.S.C. 1851(h)(6).

Question 31. Would references to accounting treatment be better formulated as safe harbors or presumptions within the short-term intent prong under the 2013 final rule? Why or why not?

Question 32. What impact, if any, would the proposed accounting prong have on the liquidity of corporate bonds or other securities? Please explain.

Question 33. For purposes of determining whether certain trading activity is within the definition of proprietary trading, is the proposed accounting prong over- or under-inclusive? If over- or under-inclusive, is there another alternative that would be a more appropriate replacement for the short-term prong? Please explain. If over-inclusive, what types of transactions or positions could potentially be included in the definition of proprietary trading that should not be? Please explain, and provide specific examples of the particular transactions or positions. If under-inclusive, what types of transactions or positions could potentially be omitted from the definition of proprietary trading that should be included in light of the language and purpose of the statute? Please explain and provide specific examples of the particular transactions or positions.

Question 34. The dealer prong of the trading account definition includes accounts used for purchases or sales of one or more financial instruments for any purpose, if the banking entity is, among other things, 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. In adopting the 2013 final rule, the Agencies recognized that banking entities that are registered dealers may not have previously engaged in such an analysis, thereby resulting in a new regulatory requirement for these entities. The Agencies did, however,

note that if the regulatory analysis otherwise engaged in by banking entities was substantially similar to the dealer prong analysis, then any increased compliance burden could be small or insubstantial. Have any banking entities incurred increased compliance costs resulting from the requirement to analyze whether particular activities would require dealer registration? If so, how substantial are those additional costs and have those costs changed over time, including as a result of the banking entity becoming more accustomed to engaging in the required analysis?

Question 35. In the case of banking entities that are registered dealers, how often does the analysis of whether particular activities would require dealer registration result in identifying transactions or positions that would not be included under the dealer prong? How does the volume of those transactions or positions compare to the volume of transactions or positions that are included under the dealer prong? What types of transactions or positions would not be included under the dealer prong and how often are those transactions included by a different part of the definition of "trading account," namely the short-term prong?

Question 36. For transactions or positions not covered by the dealer prong, would those transactions or positions be covered by the proposed accounting treatment prong? Why or why not?

Question 37. As compared to the 2013 final rule's dealer and short-term intent prongs taken together, would the proposed accounting prong result in a greater or lesser amount of trading activity being included in the definition of "trading account"? What are the resulting costs and benefits? In responding to this question, commenters are encouraged to be as specific as possible in describing the transactions or positions used to support their analysis.

Question 38. Would banking entities regulated by Agencies that are market regulators incur additional (or lesser) compliance costs or burdens in the course of complying with the proposal as compared to the costs and burdens of other banking entities? How would the costs

and burdens incurred by these banking entities compare as a whole to those of other banking entities? Please explain.

c. Presumption of Compliance with the Prohibition on Proprietary Trading

The Agencies propose to include a presumption of compliance with the proposed rule's proprietary trading prohibition based on an objective, quantitative measure of a trading desk's activities. This presumption of compliance would apply to a banking entity's individual trading desks rather than to the banking entity as a whole. As described below, a trading desk operating pursuant to the proposed presumption would not be obligated to demonstrate that the activities of the trading desk comply with subpart B on an ongoing basis. The proposed presumption would only be available for a trading desk's activities that may be within the trading account under the proposed accounting prong, for a trading desk that is not subject to the market risk capital prong or the dealer prong of the trading account definition. The replacement of the short-term intent prong with the accounting prong would represent a significant change from the 2013 final rule and could potentially apply to certain activities that were previously not within the regulatory definition of trading account. However, the presumption of compliance would limit the expansion of the definition of "trading account" to include—unless the presumption is rebutted—only the activities of a trading desk that engages in a greater than de minimis amount of activity (unless the presumption is rebutted).

The proposed presumption would not be available for trading desks that purchase or sell positions that are within the trading account under the market risk capital prong or the dealer prong. The Agencies are not proposing to extend the presumption of compliance with the prohibition on proprietary trading to activities of banking entities that are included under the market risk capital prong or the dealer prong because, based on their experience implementing

the 2013 final rule, the Agencies believe that these two prongs are reasonably designed to include the appropriate trading activities. Banking entities subject to the market risk capital prong and the dealer prong have had several years of experience complying with the requirements of the 2013 final rule and experience with identifying these activities in other contexts. The Agencies believe that banking entities with activities that are covered by these prongs are able to conduct appropriate trading activities in an efficient manner pursuant to exclusions from the definition of proprietary trading or pursuant to the exemptions for permitted activities. The Agencies further note that the proposed revisions to the exemptions (described herein) are intended to facilitate the ability of banking entities subject to the market risk capital prong and the dealer prong to better engage in otherwise permitted activities such as market-making. Additionally, the Agencies note that the presumption of compliance with the prohibition on proprietary trading is optional for a banking entity. Accordingly, if a banking entity prefers to demonstrate ongoing compliance for activity captured by the accounting prong rather than calculating the threshold for presumed compliance described below, it may do so at its discretion.

Under the proposed compliance presumption, the activities of a trading desk of a banking entity that are not covered by the market risk capital prong or the dealer prong would be presumed to comply with the proposed rule's prohibition on proprietary trading if the activities do not exceed a specified quantitative threshold. The trading desk would remain subject to the prohibition, but unless the desk engages in a material level of trading activity (or the presumption of compliance is rebutted as described below), the desk would not be required to comply with the more extensive requirements that would otherwise apply under the proposal in order to demonstrate compliance. As described further below, the Agencies propose to use the absolute

value of the trading desk's profit and loss ("absolute P&L") on a 90-calendar-day rolling basis as the relevant quantitative measure for this threshold.

The proposed rule includes a threshold for the presumption of compliance based on absolute P&L because this measure tends to correlate with the scale and nature of a trading desk's trading activities.[69] In addition, if the positions of a trading desk have recently significantly contributed to the financial position of the banking entity, such that the absolute P&L-based threshold is exceeded, the proposed trading-desk-level presumption would become unavailable and the banking entity would be required to comply with more extensive requirements of the rule to ensure compliance. Using absolute P&L as the relevant measure of trading desk risk would provide an additional advantage as an objective measure that most banking entities are already equipped to calculate.[70] This measure would also indicate the realized outcomes of the risks of a trading desk's positions, rather than modeled estimates.

In general, the proposed presumption of compliance would take the approach that a trading desk that consistently does not generate more than a threshold amount of absolute P&L does not engage in trading activities of a sufficient scale to warrant the costs associated with more extensive requirements of the rule to otherwise demonstrate compliance with the prohibition on proprietary trading. Such an approach is intended to reflect a view that the lesser activity of these trading desks does not justify the costs of an extensive ongoing compliance

[69] For example, trading desks that contemporaneously and effectively offset or hedge the assets and liabilities that they acquire through trades with customers as a result of engagement in customer-driven activities could be expected under most conditions to generally experience lower amounts of daily profit or loss attributable to daily fluctuations in the value of the desk's positions than desks engaged in speculative activities.

[70] Some banking entities without meaningful trading activities may not currently calculate P&L as described in this proposal, but the Agencies believe that many, if not most, of those banking entities would be banking entities with limited trading assets and liabilities that would be presumed to comply with the proposed rule under proposed § __.20(g).

regime for those trading desks in order to ensure compliance with section 13 of the BHC Act and the implementing regulations.

Under the proposal, each trading desk that operates under the presumption of compliance with the prohibition on proprietary trading would be required to determine on a daily basis the absolute value of its net realized and unrealized gains or losses on its portfolio of financial instruments based on the fair value of the financial instruments. The sum of the absolute values of gains or losses for each trading date in any 90-calendar-day period is the trading desk's 90-calendar-day absolute P&L. If this value exceeds $25 million at any point, then the banking entity would be required to notify the appropriate Agency that it has exceeded the threshold in accordance with the Agency's notification policies and procedures.

The Agencies propose to use the absolute value of a trading desk's daily P&L because absolute value would ensure that losses would be counted toward the measurement to the same extent as gains. Thus, a trading desk could not avoid triggering compliance by offsetting significant net gains on one day with significant net losses on another day. Measuring absolute P&L on a rolling basis would mean that the threshold could be triggered in any 90-calendar-day period.

This proposed trading-desk-level presumption of compliance with the prohibition on proprietary trading would be 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, in particular, the proposed accounting prong.[71]

[71] Provided that a trading desk's absolute P&L does not exceed the $25 million threshold, a banking entity would not have to assess the accounting treatment of each transaction of a trading desk that operates pursuant to the presumption of compliance with the prohibition on proprietary trading.

As noted above, one advantage of using absolute P&L as the relevant measure of trading desk risk is that it would provide a relatively simple and objective measure that most banking entities are already equipped to calculate. For example, banking entities subject to the current metrics reporting requirements should already be equipped to calculate P&L on a daily basis. Other banking entities with significant trading activities likely currently calculate P&L on a daily basis for the purpose of monitoring their positions and risks. Moreover, a banking entity's methodology for calculating P&L is generally subject to internal and external audit requirements, managerial monitoring, and applicable public reporting requirements under the U.S. securities laws. Under the proposed approach, the Agencies would review banking entities' methodologies for calculating absolute P&L for purposes of the presumption of compliance with the prohibition on proprietary trading.

The specific threshold chosen aims to characterize trading desks not engaged in prohibited proprietary trading. Based on the metrics collected by the Agencies since issuance of the 2013 final rule, 90-calendar-day absolute P&L values below $25 million dollars are typically indicative of trading desks not engaged in prohibited proprietary trading. Under the proposal, the activities of a trading desk that exceeds the $25 million threshold would not presumptively comply with the prohibition on proprietary trading. If a trading desk operating pursuant to the proposed presumption of compliance with the prohibition on proprietary trading exceeded the $25 million threshold, the banking entity would be required to notify the appropriate Agency, demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B (e.g., the desk's purchases and sales are not included in the rule's definition of trading account or meet the terms of an exclusion from the definition of proprietary trading or a permitted activity exemption), and demonstrate how the trading desk that exceeded the threshold

will maintain compliance with subpart B on an ongoing basis. The proposed presumption of compliance is intended to apply to the desks of banking entities that are not engaged in prohibited proprietary trading and is not intended as a safe harbor. The Agencies therefore propose to include within the presumption of compliance a process by which an Agency may rebut this regulatory presumption of compliance. Under the proposal, the Agency would be able to rebut the presumption of compliance with the prohibition on proprietary trading for the activities of a trading desk that does not exceed the $25 million threshold by providing the banking entity written notification of the Agency's determination that one or more of the trading desk's activities violates the prohibition on proprietary trading under subpart B.

In addition, the proposed rule includes a reservation of authority (described further below) that would allow an Agency to designate any activity as a proprietary trading activity if the Agency determines on a case-by-case basis that the banking entity has engaged as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments under 12 U.S.C. § 1851(h)(6).

Question 39. Should the Agencies consider any objective measures other than accounting treatment to replace the 2013 final rule's short-term intent prong? For example, should the Agencies consider including an objective quantitative threshold (such as the absolute P&L threshold described in the proposed presumption of compliance with the proprietary trading prohibition) as an element of the trading account definition? Why or why not, and how would such a measure be consistent with the requirements of section 13 of the BHC Act?

Question 40. Is the proposed desk-level threshold for presumed compliance with the prohibition on proprietary trading ($25 million absolute P&L) an appropriate measure for indicating that the scale of a trading desk's activities may not warrant the cost of more extensive

compliance requirements? Why or why not? If not, what other measure would be more appropriate? If absolute P&L is an appropriate measure, is $25 million an appropriate threshold? Why or why not? Should this threshold be periodically indexed for inflation?

Question 41. What issues do commenters expect would arise if the $25 million threshold is applied to each trading desk at a banking entity? Would variations in levels and types of activity of the different trading desks raise challenges in the application of the threshold?

Question 42. What factors, if any, should the Agencies keep in mind as they consider how the $25 million threshold should be applied over time, as trading desks' activities change and banking entities may reorganize their trading desks? Would the $25 million threshold require any adjustment if a banking entity consolidated more than one trading desk into one, or split the activities of a trading desk among multiple trading desks?

Question 43. As described further below, the Agencies are requesting comment regarding a potential change to the definition of "trading desk" that would allow a banking entity greater discretion to define the business units that constitute trading desks for purposes of the 2013 final rule. If the Agencies were to adopt both this change to the definition of "trading desk" and the trading desk-level presumption of compliance described above, would such a combination create opportunities for evasion? If so, how could such concerns be mitigated?

Question 44. Recognizing that the Agencies that are market regulators operate under an examination and enforcement model that differs from a bank supervisory model, from a practical perspective would the proposal to replace the current short-term intent prong with an accounting prong, including the presumption of compliance, apply differently to banking entities regulated by market regulators as compared to other banking entities? Please explain.

Question 45. Is the process by which the Agencies may rebut the presumption of compliance sufficiently clear? If not, how should the process be changed?

Question 46. Under the proposed presumption of compliance, banking entities would be required to notify the appropriate Agency whenever the activities of a trading desk with the relevant activities crosses the $25 million P&L threshold. Should the Agencies consider an alternative methodology in which a banking entity regulated by the SEC or CFTC, as appropriate, makes and keeps a detailed record of each instance and provides such records to SEC or CFTC staff promptly upon request or during an examination? Why or why not?

Question 47. Would an alternative methodology to the notification requirement, applicable solely to banking entities regulated by Agencies that are market regulators, whereby these firms would be required to escalate notices of instances when the P&L threshold has been exceeded internally for further inquiry and determination as to whether notice should be given to the applicable regulator, using objective factors provided by the rule? Why or why not? If such an approach would be more appropriate, what objective factors should be used to determine when notice should be given to the applicable regulator? Please be as specific as possible.

Question 48. Should the Agencies specify notice and response procedures in connection with an Agency determination that the presumption is rebutted pursuant to § __.3(c)(2) of the proposal? Why or why not? If not, what other approach would be appropriate?

d. Excluded activities.

As previously discussed, § __.3 of the 2013 final rule generally prohibits a banking entity from engaging in proprietary trading.[72] In addition to defining the scope of trading activity subject to the prohibition on proprietary trading, the 2013 final rule also provides several

[72] *See* 2013 final rule § __.3(a).

exclusions from the definition of proprietary trading.[73] Based on their experience implementing the 2013 final rule, the Agencies are proposing to modify the exclusion for liquidity management and to adopt new exclusions for transactions made to correct errors and for certain offsetting swap transactions. In addition, the Agencies request comment regarding whether any additional exclusions should be added, for example, to address certain derivatives entered into in connection with a customer lending transaction.

1. *Liquidity Management Exclusion*

The 2013 final rule excludes from the definition of proprietary trading the purchase or sale of securities for the purpose of liquidity management in accordance with a documented liquidity management plan.[74] This exclusion is subject to several requirements. First, the liquidity management exclusion is limited by its terms to securities and requires that transactions be 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 entity's liquidity management; and the liquidity circumstances in which the particular securities may or must be used. Second, any purchase or sale of securities contemplated and authorized by the plan must be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes. Third, the plan must require that any securities purchased or sold for liquidity management purposes be highly liquid and limited to instruments the market, credit, and other risks of which the banking entity does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price

[73] *See* 2013 final rule § __.3(d).

[74] *See* 2013 final rule § __.3(d)(3).

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 final rule and the 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. These requirements are designed to ensure that the liquidity management exclusion is not misused for the purpose of impermissible proprietary trading.[75]

The Agencies propose to amend 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,[76] 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. Currently, the liquidity management exclusion is limited to the "purchase or sale of a security… for the purpose of liquidity management…" if several specified requirements are met.[77] As a result, banking entities may not currently rely on the liquidity management exclusion for foreign exchange derivative transactions used for liquidity management because the exclusion is limited to securities. However, the Agencies understand

[75] *See* 79 FR at 5555.

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

[77] § __.3(d)(3) of the proposed rule (emphasis added).

that banking entities often use foreign exchange forwards, foreign exchange swaps, and cross-currency swaps for liquidity management purposes. In particular, 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. For example, foreign branches and subsidiaries of U.S. banking entities often have liquidity requirements mandated by foreign jurisdictions, and foreign exchange products can be used to address currency risk arising from holding this liquidity in foreign currencies. As a particular example, a U.S. banking entity may have U.S. dollars to fund its operations but require Japanese yen for its branch in Japan. The banking entity could use a foreign exchange swap to convert its U.S. dollars to Japanese yen to fund the operations of its Japanese branch.

To streamline compliance for banking entities operating in foreign jurisdictions and using foreign exchange forwards, foreign exchange swaps, and cross-currency swaps for liquidity management purposes, the Agencies propose to expand 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 physically-settled cross-currency swaps[78] entered into by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan. The proposed rule would permit a banking entity to purchase or sell foreign exchange forwards, foreign exchange

[78] The Agencies propose to define 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 when the swap is entered into. 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.

swaps, and physically-settled cross-currency swaps to the same extent that a banking entity may purchase or sell securities under the existing exclusion, and the existing conditions that apply for securities transactions would also apply to transactions in foreign exchange forwards, foreign exchange swaps, and physically-settled cross-currency swaps.[79]

The inclusion of cross-currency swaps would be limited to swaps for which all payments are made in the currencies being exchanged, as opposed to cash-settled swaps, to limit the potential for these instruments to be used for proprietary trading that is not for liquidity management purposes. While foreign exchange forwards and foreign exchange swaps, as defined in the Commodity Exchange Act, are by definition limited to an exchange of the designated currencies, no similarly limited definition of the term "cross-currency swap" is available for this purpose. 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. Accordingly, out of concern that cross-currency swaps could be used for prohibited proprietary trading, the Agencies propose to limit the use of cross-currency swaps for purposes of the liquidity management exclusion to only those swaps for which the payments are made in the two currencies being exchanged.

Question 49. In addition to the example noted above, are there additional scenarios under which commenters would envision foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps to be used for liquidity management? Are the existing conditions of the liquidity management exclusion appropriate for these types of derivatives activities, or should additional conditions be added to account for the particular characteristics of

[79] *See* § __.3(e)(3)(i)-(vi) of the proposed rule.

the financial instruments that the Agencies are proposing to be added? Should any existing restrictions be removed to account for the proposed addition of these transactions?

Question 50. Do the requirements of the existing liquidity management exclusion, as proposed to be modified by expanding the exclusion to include foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps, sufficiently protect against the possibility of banking entities using the exclusion to conduct impermissible speculative trading, while also permitting bona fide liquidity management? Should the proposal be further modified to protect against the possibility of firms using the liquidity management exclusion to evade the requirements of section 13 of the BHC Act and implementing regulations?

Question 51. Should banking entities be permitted to purchase and sell physically-settled cross-currency swaps under the liquidity management exclusion? Should banking entities be permitted to purchase and sell any other financial instruments under the liquidity management exclusion?

2. *Transactions to correct bona fide trade errors*

The Agencies understand that, from time to time, a banking entity may erroneously execute a purchase or sale of a financial instrument in the course of conducting a permitted or excluded activity. For example, a trading error may occur when a banking entity is acting solely in its capacity as an agent, broker, or custodian pursuant to § __.3(d)(7) of the 2013 final 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. Under the 2013 final rule, banking entities have expressed concern that 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.

Accordingly, the Agencies are proposing a new exclusion from the definition of proprietary trading for trading errors and subsequent correcting transactions because such transactions do not appear to be the type of transaction the statutory definition of "proprietary trading" was intended to cover. In particular, these transactions generally lack the intent described in the statutory definition of "trading account" to profit from short-term price movements. The proposed exclusion would be available for certain purchases or sales of one or more financial instruments by a banking entity if the purchase (or sale) is made in error in the course of conducting a permitted or excluded activity or is a subsequent transaction to correct such an error. The Agencies note that the availability of the proposed exclusion will depend on the facts and circumstances of the transactions. For example, the failure of a banking entity to make reasonable efforts to prevent errors from occurring—as indicated, for example, by the magnitude or frequency of errors, taking into account the size, activities, and risk profile of the banking entity—or to identify and correct trading errors in a timely and appropriate manner may indicate trading activity that is not truly an error and therefore inconsistent with the exclusion.

As an additional condition, once the banking entity identifies purchases made in error, it would be required to transfer the financial instrument to a separately-managed trade error account for disposition, as a further indication that the transaction reflects a bona fide error. The Agencies believe that this separately-managed trade error account should be monitored and

managed by personnel independent from the traders who made the error and that banking entities should monitor and manage trade error corrections and trade error accounts. Doing so would help prevent personnel from using these accounts to evade the prohibition on proprietary trading, such as by retaining positions in error accounts to benefit from short-term price movements or by intentionally and incorrectly classifying transactions as error trades or as corrections of error trades in order to realize short term profits.

Question 52. Does the proposed exclusion align with existing policies and procedures that banking entities use to correct trading errors? Why or why not?

Question 53. Is the proposed exclusion for bona fide errors sufficiently narrow so as to prevent banking entities from evading other requirements of the rule? Conversely, would it be too narrow to be workable? Why or why not?

Question 54. Do commenters believe that the proposed exclusion for bona fide trade errors is sufficiently clear? If not, why not, and how should the Agencies clarify it?

Question 55. Does the proposed exclusion conflict with any of the requirements of a self-regulatory organization's rules for correcting trading errors? If it does, should the Agencies give banking entities the option of complying with those rules instead of the requirements of the proposed exclusion? When answering this question, commenters should explain why the rules of self-regulatory organizations are sufficient to prevent personnel from evading the prohibition on proprietary trading.

Question 56. Should the Agencies provide specific criteria or factors to help banking entities determine what constitutes a separately managed trade error account? Why or why not? How would these factors or criteria help banking entities identify activities that are covered by the proposed exclusion for trading errors?

3. Definition of other terms related to proprietary trading.

The Agencies are requesting comment on alternatives to the 2013 final rule's definition of "trading desk." The trading desk definition is significant because compliance with the underwriting and market-making provisions is determined at the trading-desk level.[80] For example, the "reasonably expected near-term customer demand," or RENTD, requirements for both underwriting and market-making activities must be calculated for each trading desk.[81] Additionally, under the 2013 final rule, banking entities must furnish metrics at the trading-desk level.[82] Further, the proposed presumption of compliance with the prohibition on proprietary trading would require trading desks operating pursuant to the presumption to calculate absolute P&L at the trading desk level and would apply to all the activities of the trading desk.

Under the 2013 final rule, "trading desk" is defined as "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof."[83] Some banking entities have indicated that, in practice, this definition has led to uncertainty regarding the meaning of "smallest discrete unit." Some banking entities have also communicated that this definition has caused confusion and duplicative compliance and reporting efforts for banking entities that also define trading desks for purposes not related to the 2013 final rule, including for internal risk management and reporting and calculating regulatory capital requirements.

Accordingly, the Agencies are requesting comment on whether to revise the trading desk definition to align with the trading desk concept used for other purposes. The Agencies are

[80] *See* 2013 final rule § __.4(a)(2); § __.4(b)(2).

[81] *See* 2013 final rule § __.4(b)(2)(ii).

[82] *See* 2013 final rule Appendix A.

[83] 2013 final rule § __.3(e)(13).

seeking comment on a potential multi-factor trading desk definition based on the same criteria typically used to establish trading desks for other operational, management, and compliance purposes. For example, the Agencies could define a trading desk as 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:

- Structured by the banking entity to establish efficient trading for a market sector;
- Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, strategies, and compensation incentives; and
- Characterized by a clearly-defined unit of personnel that typically:
    - Engages in coordinated trading activity with a unified approach to its key elements;
    - Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;
    - Submits compliance reports and other information as a unit for monitoring by management; and
    - Books its trades together.

The Agencies believe that this potential approach to the definition of trading desk could be easier to monitor and for banking entities to apply. At the same time, however, any revised definition should not be so broad as to hinder the ability of the Agencies or the banking entities to detect prohibited proprietary trading.

Under the alternative approach on which the Agencies are requesting comment, a banking entity's trading desk designations would be subject to Agency review, as appropriate, through the examination process or otherwise. Such a definition would be intended to reduce the burdens on banking entities by aligning the regulation's trading desk concept with the organizational structure that firms already have in place for purposes of carrying out their ordinary course business activities. Specifically, to the extent the trading desk definition in the 2013 final rule has been interpreted to apply at too granular a level, the Agencies request comment as to whether such a definition would reduce compliance costs by clarifying that banking entities are not required to maintain policies and procedures and to collect and report information at a level of the organization identified solely for purposes of section 13 of the BHC Act and implementing regulations.

Question 57. Should the Agencies revise the trading desk definition to align with the level of organization established by banking entities for other purposes, such as for other operational, management, and compliance purposes? Which of the proposed factors would be appropriate to include in the trading desk definition? Do these factors reflect the same principles banking entities typically use to define trading desks in the ordinary course of business? Are there any other factors that the Agencies should consider such as, for example, how a banking entity would monitor and aggregate P&L for purposes other than compliance with section 13 of the BHC Act and the implementing regulation?

Question 58. How would the adoption of a different trading desk definition affect the ability of banking entities and the Agencies to detect impermissible proprietary trading? Please explain. Would a different definition of "trading desk" make it easier or harder for banking entities and supervisors to monitor their trading activities for consistency with section 13 of the

BHC Act and implementing regulations? Would allowing banking entities to define "trading desk" for purposes of compliance with section 13 of the BHC Act and the implementing regulations create opportunities for evasion, and if so, how could such concerns be mitigated?

Question 59. Please discuss any positive or negative consequences or costs and benefits that could result if a "trading desk" is not defined as "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof." Please include in your discussion any positive or negative impact with respect to (i) the ability to record the quantitative measurements required in the Appendix and (ii) the usefulness of such quantitative measurements.

e. Reservation of authority

The Agencies propose to include a reservation of authority allowing 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.[84] In evaluating whether the Agency should designate a purchase or sale as for the trading account, the Agency will consider consistency with the statutory definition, and, to the extent appropriate and consistent with the statute, may consider the impact of the activity on the safety and soundness of the financial institution or the financial stability of the United States, the risk characteristics of the particular activity, or any other relevant factor.

The Agencies request comment as to whether such a reservation of authority would be necessary in connection with the proposed definition of trading account, which would focus on objective factors rather than on subjective intent.[85] While the Agencies recognize that the use of

[84] 12 U.S.C. 1851(h)(6).

[85] *See* § __.3(b) of the proposed rule.

objective factors to define proprietary trading is intended to simplify compliance, the Agencies also recognize that this approach may, in some circumstances, produce results that are either under-inclusive or over-inclusive with respect to the definition of proprietary trading. The Agencies further recognize that the underlying statute sets forth elements of proprietary trading that are inherently subjective, for example, "intent to resell in order to profit from short-term price movements."[86] In order to provide appropriate balance and to recognize the subjective elements of the statute, the Agencies request comment as to whether a reservation of authority is appropriate.

The Agencies propose to administer this reservation of authority with appropriate notice and response procedures. In those circumstances where the primary financial regulatory agency of a banking entity determines that the purchase or sale of one or more financial instruments is for the trading account, the Agency would be required to provide written notice to the banking entity explaining why the purchase or sale is for the trading account. The Agency would also be required to provide the banking entity with a reasonable opportunity to provide a written response before the Agency reaches a final decision. Specifically, a banking entity would have 30 days to respond to the notice with any objections to the determination and any factors that the banking entity would have the Agency consider in reaching its final determination. The Agency could, in its discretion, extend the response period beyond 30 days for good cause. The Agency could also shorten the response period if the banking entity consents to a shorter response period or, if, in the opinion of the Agency, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new response period. Failure to respond within the time period would amount to a waiver of any objections to the Agency's

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

determination that a purchase or sale is for the trading account. After the close of banking entity's response period, the Agency would decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the Agency's determination that the purchase or sale is for the trading account. The banking entity would be notified of the decision in writing. The notice would include an explanation of the decision.[87]

Question 60. Is the reservation of authority to allow the appropriate Agency to determine whether a particular activity is proprietary trading appropriate? Why or why not?

Question 61. Would the proposed reservation of authority further the goals of transparency and consistency in interpretation of section 13 of the BHC Act and the implementing regulations? Would it be more appropriate to have these type of determinations made jointly by the Agencies? Is the standard by which an Agency would make a determination under the proposed reservation of authority sufficiently clear? If determinations are not made jointly by the Agencies, what concerns could be presented if two banking entity affiliates receive different or conflicting determinations from different Agencies?

Question 62. Should Agencies' determinations pursuant to the reservation of authority be made public? Would publication of such determinations further the goals of consistency and transparency? Please explain. Should the Agencies follow consistent practices with respect to publishing notices of determinations pursuant to the reservation of authority?

Question 63. Are the notice and response procedures adequate? Why or why not? Recognizing that market regulators operate under a different regulatory structure as compared to the Federal banking agencies, should the proposed notice and response procedures be modified

[87] These notice and response procedures would be consistent with procedures that apply to many banking entities in other contexts. *See* 12 CFR 3.404.

to account for such differences (including by creating separate procedures that would be applicable solely in the case of reporting to market regulators)? Why or why not?

2. Section __.4: Permitted underwriting and market-making activities

a. Permitted underwriting activities

Section 13(d)(1)(B) of the BHC Act contains an exemption from the prohibition on proprietary trading for the purchase, sale, acquisition, or disposition of securities, derivatives, contracts of sale of a commodity for future delivery, and options on any of the foregoing in connection with underwriting activities, to the extent that such activities are designed not to exceed RENTD.[88] Section __.4(a) of the 2013 final 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 final 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 the reasonably expected near term demands of clients, customers, or counterparties, 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

[88] 12 U.S.C. 1851(d)(1)(B).

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 the reasonably expected near term demands of clients, customers, or counterparties, on the amount, types, and risk of the trading desk's underwriting position, level of exposures to relevant risk factors arising from the trading desk's underwriting position, and 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.

As the Agencies explained in the 2013 final rule, underwriters play an important role in facilitating issuers' access to funding, and thus underwriters are important to the capital

formation process and economic growth.[89] Obtaining new financing can be expensive for an issuer because of the natural information advantage that less well-known issuers have over investors about the quality of their future investment opportunities.[90] An underwriter can help reduce these costs by mitigating the information asymmetry between an issuer and its potential investors.[91] The underwriter does this based in part on its familiarity with the issuer and other similar issuers as well as by collecting information about the issuer. This allows investors to look to the reputation and experience of the underwriter as well as its ability to provide information about the issuer and the underwriting.[92]

In recognition of how the underwriting market functions, the Agencies adopted a comprehensive, multi-faceted approach in the 2013 final rule. In the several years since the adoption of the 2013 final rule, however, public commenters have observed that the significant compliance requirements in the regulation may unnecessarily constrain underwriting without a corresponding reduction in the type of trading activities that the rule was designed to prohibit.[93]

As described in further detail below, the Agencies are proposing to tailor, streamline, and clarify the requirements that a banking entity must satisfy to avail itself of the underwriting exemption. In that regard, the Agencies are proposing to modify the underwriting exemption to clarify how a banking entity may measure and satisfy the statutory requirement that underwriting activity be designed not to exceed the reasonably expected near term demand of clients, customers, or counterparties. Specifically, the proposal would establish a presumption, available

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

[90] *See id.*

[91] *See id.*

[92] *See id.*

[93] *See supra* Part I.A of this Supplementary Information section.

to banking entities both with and without significant trading assets and liabilities, that trading within internally set risk limits satisfies the statutory requirement that permitted underwriting activities must be designed not to exceed RENTD.

The Agencies also are proposing to tailor the underwriting exemption's 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. Based on feedback the Agencies have received, banking entities that do not have significant trading assets and liabilities can incur costs to establish, implement, maintain, and enforce the compliance program requirements in the 2013 final rule, notwithstanding the lower level of such banking entities' trading activities.[94] Accordingly, the Agencies believe that the proposed revisions to the underwriting exemption would provide banking entities that do not have significant trading assets and liabilities with more flexibility to meet client and customer demands and facilitate the capital formation process, while, consistent with the statute, continuing to safeguard against trading activity that could threaten the safety and soundness of banking entities and the financial stability of the United States, by more appropriately aligning the associated compliance obligations with the size of banking entities' trading activities.

b. RENTD limits and presumption of compliance.

As described above, the statutory exemption for underwriting in section 13(d)(1)(B) of the BHC Act requires that such activities be designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.[95] Consistent with the statute, § __.4(a)(2)(ii) of the 2013 final rule's underwriting exemption requires that the amount and type of the securities in the trading desk's underwriting position be designed not to exceed the

[94] *Id.*

[95] 12 U.S.C. 1851(d)(1)(B).

reasonably expected near term demands of clients, customers, or counterparties, and reasonable efforts are made to sell or otherwise reduce the underwriting position within a reasonable period, taking into account the liquidity, maturity, and depth of the market for the relevant type of security.[96]

The Agencies' experience implementing the 2013 final rule has indicated that the approach the Agencies have taken to give effect to the statutory standard of reasonably expected near term demands of clients, customers, or counterparties may be overly broad and complex, and also may inhibit otherwise permissible underwriting activity. The Agencies have received feedback as part of implementing the rule that compliance with the factors in the rule can be complex and costly.[97]

Instead of the approach for the underwriting exemption in the 2013 final rule, the Agencies are proposing to establish the articulation and use of internal risk limits as a key mechanism for conducting trading activity in accordance with the rule's underwriting exemption.[98] In particular, the proposal would provide that the purchase or sale of a financial instrument by a banking entity shall be presumed to be designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties if the banking entity establishes internal risk limits for each trading desk, subject to certain conditions, and implements, maintains, and enforces those limits, such that the risk of the financial instruments held by the trading desk does not exceed such limits. The Agencies believe that this

[96] *See* 2013 final rule § __.4(a)(2)(ii).

[97] *See supra* Part I.A. of this SUPPLEMENTARY INFORMATION section.

[98] As a consequence of these proposed changes to focus on risk limits, many of the requirements of the 2013 final rule relating to risk limits associated with underwriting would be incorporated into this requirement and modified or removed as appropriate in this section of the proposal.

approach would provide firms with more flexibility and certainty in conducting permissible underwriting.

Under the proposal, 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 statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act by establishing and complying with these internal risk limits. Specifically, the proposal would provide that a banking entity would establish internal risk limits for each trading desk 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.

Banking entities utilizing this presumption would be required to maintain internal policies and procedures for setting and reviewing desk-level risk limits in a manner consistent with the statute.[99] The proposed approach would not require that a banking entity's risk limits be based on any specific or mandated analysis, as required under the 2013 final rule. Rather, a banking entity would establish the risk limits according to its own internal analyses and

[99] Under the proposal, banking entities with significant trading assets and liabilities would continue to be required to establish internal risk 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). Banking entities that do not have significant trading assets and liabilities would no longer be required to establish a compliance program that is specific for the purposes of complying with the exemption for underwriting, but would need to do so 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.

processes around conducting its underwriting activities in accordance with section 13(d)(1)(B).[100]

The proposal would require a banking entity to promptly report to the appropriate Agency when a trading desk exceeds or increases its internal risk limits. A banking entity would also be required to report to the appropriate Agency any temporary or permanent increase in an internal risk limit. In the case of both reporting requirements (i.e., notice of an internal risk limit being exceeded and notice of an increase to the limit), the notice would be submitted in the form and manner as directed by the applicable Agency.

As noted, a banking entity would not be required to adhere to any specific, pre-defined requirements for the limit-setting process beyond the banking entity's own ongoing and internal assessment of the amount of activity that is required to conduct underwriting, including to reflect the banking entity's ongoing and internal assessment of the reasonably expected near term demands of clients, customers, or counterparties. The proposal would, however, provide that internal risk limits established by a banking entity shall be subject to review and oversight by the appropriate Agency on an ongoing basis. Any review of such limits would assess whether or not those limits are established based on the statutory standard – i.e., the trading desk's reasonably expected near term demands of clients, customers, or counterparties on an ongoing basis, based on the nature and amount of the trading desk's underwriting activities. So long as a banking entity has established and implements, maintains, and enforces such limits, the proposal would presume that all trading activity conducted within the limits meets the requirements that the

[100] The Agencies expect that the risk and position limits metric that is already required for certain banking entities under the 2013 final 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 activities of banking entities subject to the metrics reporting and recordkeeping requirements of the Appendix. *See infra* Part III.E.2.*i*.i.

underwriting activity be based on the reasonably expected near term demands of clients, customers, or counterparties. The Agencies would expect to closely monitor and review any instances of a banking entity exceeding a risk limit as well as any temporary or permanent increase to a trading desk limit.

Under the proposal, the presumption of compliance for permissible underwriting activities may be rebutted by the 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 reasonably expected near term demands of clients, customers, or counterparties on an ongoing basis. The Agency would provide notice of any such determination to the banking entity in writing.

The Agencies request comment on the proposed addition of a presumption that conducting underwriting activities within internally set risk limits satisfies the requirement that permitted underwriting activities be designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties. In particular, the Agencies request comment on the following questions:

Question 64. Is the proposed presumption of compliance for underwriting activity within internally set risk limits sufficiently clear? If not, what changes should the Agencies make to further clarify the rule?

Question 65. How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the capital formation process and the liquidity of particular markets?

Question 66. How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the underlying objectives of section 13 of the BHC Act

and the 2013 final rule? For example, how should the Agencies assess internal trading limits and any changes in them?

Question 67. By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a 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. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?

Question 68. Would the proposal's approach to permissible underwriting activities effectively implement the statutory exemption? Why or why not? Would this approach improve the ability of banking entities to engage in underwriting relative to the 2013 final rule? If not, what approach would be better? Please explain.

Question 69. Does the proposed reliance on using a trading desk's internal risk limits to comply with the statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act present opportunities to evade the overall prohibition on proprietary trading? If so, how? Please be as specific as possible. Additionally, please provide any changes to the proposal that might address such potential circumvention. Alternatively, please explain why the proposal to rely on a trading desk's internal risk limits to comply with the statutory RENTD requirement should not present opportunities to evade the prohibition on proprietary trading.

Question 70. Do banking entities need greater clarity about how to set the proposed internal risk limits for permissible underwriting activity? If so, what additional information would be useful? Please explain.

Question 71. Are the proposed changes to the exemption for underwriting appropriately tailored to the operation and structure of the underwriting market, particularly firm commitment offerings? Could the proposal be modified in order to better align with the operation and structure of the underwriting market? Recognizing that the proposal would not require banking entities to use their internal risk limits to establish a rebuttable presumption of compliance with the requirements of section 13(d)(1)(B) of the BHC Act, would the proposal be workable in the context of underwritten offerings, including firm commitment underwritings? How would an Agency rebut the presumption of compliance in the context of underwritten offerings, including firm commitment underwritings? Could the proposal, if adopted, affect a banking entity's willingness to participate in a firm commitment underwriting? Please explain, being as specific as possible.

Question 72. Should any additional guidance or information be provided to explain the process and standard by which the Agencies could rebut the presumption of permissible underwriting? If so, please explain. Please include specific subject areas that could be addressed in such guidance (e.g., criteria used as the basis for a rebuttal, the rebuttal process, etc.).

Question 73. Are there other modifications to the 2013 final rule's requirements for permitted underwriting that would improve the efficiency of the rule's underwriting requirements while adhering to the statutory requirement that such activity be designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties? If so, please describe these modifications as well as how they would improve the efficiency of the underwriting exemption and meet the statutory standard.

Question 74. Under the proposed presumption of compliance for permissible underwriting activities, banking entities would be required to notify the appropriate Agency

when a trading limit is exceeded or increased (either on a temporary or permanent basis), in each case in the form and manner as directed by each Agency. Is this requirement sufficiently clear? Should the Agencies provide greater clarity about the form and manner for providing this notice? Should those notices be required to be provided "promptly" or should an alternative time frame apply? Alternatively, should each Agency establish its own deadline for when these notices should be provided? Please explain.

Question 75. Should the Agencies instead establish a uniform method of reporting when a trading desk exceeds or increases an internal risk limit (e.g., a standardized form)? Why or why not? If so, please provide as much detail as possible. If not, please describe any impediments or costs to implementing a uniform notification process and explain why such a system may not be efficient or might undermine the effectiveness of the proposed notification requirement.

Question 76: Should the Agencies implement an alternative reporting methodology for notifying the appropriate Agency when a trading limit is exceeded or increased that would apply solely in the case of a banking entity's obligation to report such occurrences to a market regulator? For example, instead of an affirmative notice requirement, should such banking entities be required to make and keep a detailed record of each instance as part of its books and records, and to provide such records to SEC or CFTC staff promptly upon request or during an examination? Why or why not? As an additional alternative, should banking entities be required to escalate notices of limit exceedances or changes internally for further inquiry and determination as to whether notice should be given to the applicable market regulator, using objective factors provided by the rule, be a more appropriate process for these banking entities? Why or why not? If such an approach would be more appropriate, what objective factors should

be used to determine when notice should be given to the applicable regulator? Please be as specific as possible.

Question 77. Should the Agencies specify notice and response procedures in connection with an Agency determination that the presumption pursuant to § __.4(a)(8)(iv) is rebutted? Why or why not? If so, what type of procedures should they specify? For example, should the notice and response procedures be similar to those in § __.3(g)(2)? If not, what other approach would be appropriate?

c. Compliance program and other requirements

The underwriting exemption in the 2013 final rule requires that a banking entity establishes and implements, maintains, and enforces a 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) 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, based on certain factors; (iii) internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and (iv) authorization procedures, including escalation procedures that require review and approval of any trade that would exceed one or more of a trading desk's limits, demonstrable analysis of the basis for any temporary or permanent increase to one or more of a trading desk's limits, and independent review (i.e., by risk managers and compliance officers at the appropriate level independent of the trading desk) of such demonstrable analysis and approval.

Banking entities and others have stated that the compliance program requirements of the underwriting exemption are overly complex and burdensome. The Agencies generally believe the compliance program requirements play an important role in facilitating and monitoring a banking entity's compliance with the exemption. However, with the benefit of experience, the Agencies also believe those requirements can be appropriately tailored to the scope of the underwriting activities conducted by each banking entity.

Specifically, the Agencies are proposing a tiered approach to the underwriting exemption's compliance program requirements so as to make them commensurate with the size, scope, and complexity of the relevant banking entity's trading activities and business structure. Consistent with the 2013 final 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 underwriting exemption. However, the Agencies propose to eliminate the exemption's compliance program requirements for banking entities that have moderate or limited trading assets and liabilities.[101]

The proposed removal of the exemption's 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 prohibitions on proprietary trading, and the other requirements of the exemption for underwriting activities, as set forth in section 13 of the BHC Act and the 2013 final rule, both as currently written and as proposed to be amended. However, eliminating the compliance program requirements as a condition to being able to rely on the underwriting exemption should provide these banking entities that do not have significant trading

[101] Under the 2013 final 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.

assets and liabilities an appropriate amount of flexibility to tailor the means by which they seek to ensure compliance with the underlying requirements of the exemption for underwriting activities, and to allow them to structure their internal compliance measures in a way that takes into account the risk profile and underwriting activity of the particular trading desk. This proposed change would also be consistent with the proposed modifications to the general compliance program requirements for these banking entities under § __.20 of the 2013 final rule, discussed further below in this Supplementary Information section.

The Agencies understand that banking entities that do not have significant trading assets and liabilities can incur significant costs to establish, implement, maintain, and enforce the compliance program requirements contained in the 2013 final rule. In some instances, those costs may be disproportionate to the banking entity's trading activity and risk. Accordingly, eliminating the compliance program requirements for banking entities that do not have significant trading assets and liabilities may reduce costs that are passed on to investors and increase capital formation without materially impacting the rule's ability to ensure that the objectives set forth in section 13 of the BHC Act are satisfied.[102]

The Agencies request comment on the proposed revisions to the exemption for the underwriting activities compliance program requirement. In particular, the Agencies request comment on the following questions:

Question 78. Would the proposed tiered compliance approach based on a banking entity's trading assets and liabilities appropriately balance the costs and benefits for banking

[102] Under the proposal, the compliance program requirements that are specific for the purposes of complying with the exemption for underwriting activities in § __.4(a) would remain unchanged for banking entities with significant trading assets and liabilities, although the requirements related to limits for each trading desk would be moved (but not modified) into new § __.4(a)(8)(i) as part of the proposed presumption of compliance.

entities that do not have significant trading assets and liabilities? Why or why not? If so, how? If not, what other approach would be more appropriate?

Question 79. Should the Agencies simplify and streamline the exemption for underwriting activities compliance requirements for banking entities with significant trading assets and liabilities? If so, please explain.

Question 80. Do commenters agree with the proposal to have the underwriting exemption specific compliance program requirements apply only to banking entities with significant trading assets and liabilities? Why or why not?

Question 81. In addition to the proposed changes to the underwriting exemption, are there any technical corrections the Agencies should make to § __.4(a), such as to eliminate redundant or duplicative language or to correct or refine certain cross-references? If so, please explain.

d. Market-making activities

Section 13(d)(1)(B) of the BHC Act contains an exemption from the prohibition on proprietary trading for the purchase, sale, acquisition, or disposition of securities, derivatives, contracts of sale of a commodity for future delivery, and options on any of the foregoing in connection with 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.[103] Section __.4(b) of the 2013 final 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 final rule requires that:

[103] 12 U.S.C. 1851(d)(1)(B).

- 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, the reasonably expected near term demands of clients, customers, or counterparties, 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 market making exemption, including reasonably designed written policies and procedures, internal controls, analysis, and independent testing identifying and assessing certain specified factors;[104]

- To the extent that any required limit[105] 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;

[104] *See* 79 FR at 5612.

[105] *See id*. at 5615.

- 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.

When adopting the 2013 final rule, the Agencies endeavored to balance two goals of section 13 of the BHC Act: to allow market making to take place, which is important to well-functioning and liquid markets as well as the economy, and simultaneously to prohibit proprietary trading unrelated to market making or other permitted activities, consistent with the statute.[106] To accomplish these goals the Agencies adopted a comprehensive, multi-faceted approach. In the several years since the adoption of the 2013 final rule, however, the Agencies have observed that the significant compliance requirements and lack of clear bright lines in the regulation may unnecessarily constrain market making,[107] and the Agencies believe some of the requirements are unnecessary to prevent the type of trading activities that the rule was designed to prohibit.

As described in further detail below, the Agencies are proposing to tailor, streamline, and clarify the requirements that a banking entity must satisfy to avail itself of the market making exemption. Similar to the proposed underwriting exemption,[108] the Agencies are proposing to

[106] *See id*. at 5576. In addition, staffs from some of the Agencies have analyzed the liquidity of the corporate bond market in the time since the 2013 final rule was adopted. For example, Federal Reserve Board staff have prepared quarterly reports to monitor market-level liquidity in corporate bond markets since 2014. *See* https://www.federalreserve.gov/foia/corporate-bond-liquidity-reports.htm. *See also* Report to Congress: Access to Capital and Market Liquidity, SEC Division of Economic and Risk Analysis staff, https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf ("Access to Capital and Market Liquidity").

[107] *See supra* Part I of this Supplementary Information section.

[108] *See supra* Part III.B.2.a of this SUPPLEMENTARY INFORMATION section.

modify the market making exemption by providing a clearer way to measure and satisfy the statutory requirement that market making-related activity be designed not to exceed the reasonably expected near term demand of clients, customers, or counterparties. Specifically, the proposal would establish a presumption, available to banking entities both with and without significant trading assets and liabilities, that trading within internally set risk limits satisfies the statutory requirement that permitted market making-related activities must be designed not to exceed RENTD. In addition, the Agencies also are proposing to tailor the market making exemption's 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.

Based on feedback the Agencies have received, banking entities that do not have significant trading assets and liabilities can incur substantial costs to establish, implement, maintain, and enforce the compliance program requirements in the 2013 final rule, notwithstanding the lower level of such banking entities' trading activities.[109] Accordingly, the Agencies believe that the proposed revisions to the market making exemption would provide banking entities that do not have significant trading assets and liabilities with more flexibility to meet customer demands and facilitate robust trading markets, while continuing to safeguard against trading activity that could threaten the safety and soundness of banking entities and the financial stability of the United States by more appropriately aligning the associated compliance obligations with the size of banking entities' trading activities.

[109] *Id.*

e. RENTD limits and presumption of compliance.

As described above, the statutory exemption for market making-related activities in section 13(d)(1)(B) of the BHC Act requires that such activities be designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.[110] Consistent with the statute, § __.4(b)(2)(ii) of the 2013 final rule's market making exemption requires that the amount, types, and risks of the financial instruments in the trading desk's market maker inventory be designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on certain market factors and analysis.[111]

The 2013 final rule provides two factors for assessing whether the amount, types, and risks of the financial instruments in the trading desk's market maker inventory are designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties. 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. Under § __.4(b)(2)(iii)(C) of the 2013 final rule, a banking entity must account for these considerations when establishing risk and inventory limits for each trading desk.

The Agencies' experience implementing the 2013 final rule has indicated that the approach the Agencies have taken to give effect to the statutory standard of reasonably expected near term demands of clients, customers, or counterparties may be overly broad and complex, and also may inhibit otherwise permissible market making-related activity. In particular, the

[110] 12 U.S.C. 1851(d)(1)(B).

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

Agencies have received feedback as part of implementing the rule that compliance with the factors in the rule can be complex and costly.[112] For example, banking entities have communicated that they must engage in a number of complex and intensive analyses to meet the "demonstrable analysis" requirement under § __.4(b)(2)(ii)(B) and may still be unable to gain comfort that their bona fide market making-related activity meets these factors. Finally, the Agencies' experience implementing the rule also indicates that the requirements of the 2013 final rule do not provide bright line conditions under which trading can clearly be classified as permissible market making.

Accordingly, the Agencies are seeking comment on a proposal to implement this key statutory factor in a manner designed to provide banking entities and the Agencies with greater certainty and clarity about what activity constitutes permissible market making pursuant to the exemption. The Agencies are proposing to establish the articulation and use of internal risk limits as a key mechanism for conducting trading activity in accordance with the rule's market making exemption.[113] In particular, the proposal would provide that the purchase or sale of a financial instrument by a banking entity shall be presumed to be designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or counterparties, based on the liquidity, maturity, and depth of the market for the relevant types of financial instrument, if the banking entity establishes internal risk limits for each trading desk, subject to certain conditions, and implements, maintains, and enforces those limits, such that the risk of the financial instruments held by the trading desk does not exceed such limits. The

[112] *See supra* Part I.A.

[113] As a consequence of these changes to focus on risk limits, many of the requirements of the 2013 final rule relating to risk limits associated with market making-related activity have been incorporated into this requirement and modified or deleted as appropriate in this section of the proposal.

Agencies believe that this approach would allow for a clearer application of these exemptions, and would provide firms with more flexibility and certainty in conducting market making-related activities.

Under the proposal, 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 statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act by establishing and complying with internal risk limits. Specifically, the proposal would provide that a banking entity would establish internal risk limits for each trading desk 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, on the:

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

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

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

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

Banking entities utilizing this presumption would be required to maintain internal policies and procedures for setting and reviewing desk-level risk limits in a manner consistent with the statute.[114] The proposed approach would not require that a banking entity's risk limits

[114] Under the proposal, banking entities with significant trading assets and liabilities would continue to be required to establish internal risk limits for each trading desk as part of the market making compliance program requirement 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 no longer be required to establish a compliance program that is specific for the purposes of complying with the exemption for market making-related activity, but would need to establish and implement, maintain, and enforce these limits if

be based on any specific or mandated analysis, as required under the 2013 final rule. Rather, a banking entity would establish the risk limits according to its own internal analyses and processes around conducting its market making activities in accordance with section 13(d)(1)(B).[115]

The proposal would require a banking entity to promptly report to the appropriate Agency when a trading desk exceeds or increases its internal risk limits. A banking entity would also be required to report to the appropriate Agency any temporary or permanent increase in an internal risk limit. In the case of both reporting requirements (i.e., notice of an internal risk limit being exceeded and notice of an increase to the limit), the notice would be submitted in the form and manner as directed by the applicable Agency.

As noted, a banking entity would not be required to adhere to any specific, pre-defined requirements for the limit-setting process beyond the banking entity's own ongoing and internal assessment of the amount of activity that is required to conduct market making activity, including to reflect the banking entity's ongoing and internal assessment of the reasonably expected near term demands of clients, customers, or counterparties. The proposal would, however, provide that internal risk limits established by a banking entity shall be subject to review and oversight by the appropriate Agency on an ongoing basis. Any review of such limits would assess whether or not those limits are established based on the statutory standard – i.e., the trading desk's reasonably expected near term demands of clients, customers, or counterparties on

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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.

[115] The Agencies expect that the risk and position limits metric that is already required for certain banking entities under the 2013 final 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 activities of banking entities subject to the metrics reporting and recordkeeping requirements of the Appendix. *See infra* Part III.E.2.*i*.i.

an ongoing basis, based on the nature and amount of the trading desk's market making-related activities. So long as a banking entity has established and implements, maintains, and enforces such limits, the proposal would presume that all trading activity conducted within the limits meets the requirements that the market making activity be based on the reasonably expected near term demands of clients, customers, or counterparties. The Agencies would expect to closely monitor and review any instances of a banking entity exceeding a risk limit as well as any temporary or permanent increase to a trading desk limit.

Under the proposal, the presumption of compliance for permissible market making-related activities may be rebutted by the 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 reasonably expected near term demands of clients, customers, or counterparties on an ongoing basis. The Agency would provide notice of any such determination to the banking entity in writing.

The following is an example of the presumption of compliance for permissible market making-related activities. A transport company customer may seek to hedge its long-term exposure to price fluctuations in fuel by asking a banking entity to create a structured ten-year fuel swap with a notional amount of $1 billion because there is no liquid market for this type of swap. A trading desk at the banking entity that makes a market in energy swaps may respond to this customer's hedging needs by executing a custom fuel swap with the customer. If the risk resulting from activities related to the transaction does not exceed the internal risk limits for the trading desk that makes a market in energy swaps, the banking entity shall be presumed to be engaged in permissible market making-related activity that is designed not to exceed, on an ongoing basis, the reasonably expected near term demands of clients, customers, or

counterparties. Moreover, if assuming the position would result in an exposure exceeding the trading desk's limits, the banking entity could increase the risk limit in accordance with its internal policies and procedures for reviewing and increasing risk limits so long as the increase was consistent with meeting the reasonably expected near term demands of clients, customers, and counterparties.

The Agencies request comment on the proposed addition of a presumption that trading within internally set risk limits satisfies the statutory requirement that permitted market making-related activities be designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties. In particular, the Agencies request comment on the following questions:

Question 82. Is the proposed presumption of compliance for transactions that are within internally set risk limits sufficiently clear? If not, what changes would further clarify the rule? Is there another approach that would be more appropriate?

Question 83. Would the proposed approach – namely the reliance on internally set limits based on RENTD – adequately eliminate the need for a definition for "market maker inventory?" Why or why not?

Question 84. How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the liquidity of particular markets?

Question 85. How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the underlying objectives of section 13 of the BHC Act and the 2013 final rule? For example, how should the Agencies assess internal trading limits and any changes in them?

Question 86. By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a 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. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?

Question 87. Would the market making exemption, as proposed, present any problems for a trading desk that makes a market in derivatives? Are there any changes the Agencies could make to the proposal to clarify how the market making exemption applies to trading desks that make a market in derivatives?

Question 88. Would the proposal's approach to permissible market making-related activities effectively implement the statutory exemption? Why or why not? Would this approach improve the ability of banking entities to engage in market making relative to the 2013 final rule? If not, what approach would be better? Please explain.

Question 89. Does the proposed reliance on using a trading desk's internal risk limits to comply with the statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act present opportunities to evade the overall prohibition on proprietary trading? If so, how? Please be as specific as possible. Additionally, please provide any changes to the proposal that might address such potential circumvention. Alternatively, please explain whether the proposal to rely on a trading desk's internal risk limits to comply with the statutory RENTD requirement would present opportunities to evade the prohibition on proprietary trading.

Question 90. Do banking entities require greater clarity about how to set their internal risk limits for permissible market making-related activity? If so, what additional information would be useful? Please explain.

Question 91. Should any additional guidance or information be provided to explain the process and standard by which the Agencies could rebut the presumption of permissible market making, including specific subject areas that could be addressed in such guidance (e.g., criteria used as the basis for a rebuttal, the rebuttal process, etc.)? If so, please explain.

Question 92. Are there other modifications to the 2013 final rule's requirements for permitted market making that would improve the efficiency of the rule's requirements while adhering to the statutory requirement that such activity be designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties? If so, please describe these modifications as well as how they would improve the efficiency of the rule and meet the statutory standard.

Question 93. Under the proposed presumption of compliance for permissible market making-related activities, banking entities would be required to notify the appropriate Agency when a trading limit is exceeded or increased (either on a temporary or permanent basis), in each case in the form and manner as directed by each Agency. Is this requirement sufficiently clear? Should the Agencies provide greater clarity about the form and manner for providing this notice? Should those notices be required to be provided "promptly" or should an alternative timeframe apply? Alternatively, should each Agency establish its own deadline for when these notices should be provided? Please explain.

Question 94. Should the Agencies instead establish a uniform method of reporting when a trading desk exceeds or increases an internal risk limit (e.g., a standardized form)? Why or

why not? If yes, please provide as much detail as possible. If not, please describe any impediments or costs to implementing a uniform notification process and explain why such a system may not be efficient or might undermine the effectiveness of the proposed notification requirement.

Question 95: Should the Agencies implement an alternative reporting methodology for notifying the appropriate Agency when a trading limit is exceeded or increased that would apply solely in the case of a banking entity's obligation to report such occurrences to a market regulator? For example, instead of an affirmative notice requirement, should such banking entity instead be required to make and keep a detailed record of each instance as part of its books and records, and to provide such records to SEC or CFTC staff promptly upon request or during an examination? Why or why not? As an additional alternative, should banking entities be required to escalate notices of limit exceedances or changes internally for further inquiry and determination as to whether notice should be given to the applicable market regulator, using objective factors provided by the rule? Why or why not? If such an approach would be more appropriate, what objective factors should be used to determine when notice should be given to the applicable regulator? Please be as specific as possible.

Question 96. Should the Agencies specify notice and response procedures in connection with an Agency determination that the presumption pursuant to § __.4(b)(6)(iv) is rebutted? Why or why not? If so, what type of procedures should they specify? For example, should the notice and response procedures be similar to those in § __.3(g)(2)? If not, what other approach would be appropriate?

f. Compliance program and other requirements

The market making exemption in the 2013 final rule requires that a banking entity establish and implement, maintain, and enforce a 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), 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) limits for each trading desk, based on the nature and amount of the trading desk's market making activities, including the reasonably expected near term demands of clients, customers, or counterparties; (iv) internal controls and ongoing monitoring and analysis of each trading desk's compliance with its limits; and (v) authorization procedures, including escalation procedures that require review and approval of any trade that would exceed one or more of a trading desk's limits, demonstrable analysis of the basis for any temporary or permanent increase to one or more of a trading desk's limits, and independent review (i.e., by risk managers and compliance officers at the appropriate level independent of the trading desk) of such demonstrable analysis and approval.

Banking entities and others have stated that the compliance program requirements of the market making exemption can be overly complex and burdensome. The Agencies generally believe the compliance program requirements play an important role in facilitating and

monitoring a banking entity's compliance with the exemption. However, with the benefit of time and experience, the Agencies believe it is appropriate to tailor those requirements to the scope of the market making-related activities conducted by each banking entity.

Specifically, the Agencies are proposing a tiered approach to the market making exemption's compliance program requirements so as to make them commensurate with the size, scope, and complexity of the relevant banking entity's activities and business structure. Consistent with the 2013 final 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 market making exemption. However, the Agencies propose to eliminate the exemption's compliance program requirements for banking entities that have moderate or limited trading assets and liabilities.[116]

The proposed removal of the exemption's 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 prohibitions on proprietary trading, and the other requirements of the exemption for market making-related activities, as set forth in section 13 of the BHC Act and the 2013 final rule, both as currently written and as proposed to be amended. However, eliminating the compliance program requirements as a condition to being able to rely on the market making exemption should provide these banking entities that do not have significant trading assets and liabilities an appropriate amount of flexibility to tailor the means by which they seek to ensure compliance with the underlying requirements of the exemption for market making-related activities, and to allow them to structure their internal compliance

[116] Under the 2013 final rule, the compliance program requirement in § __.4(b)(2)(iii) is part of the compliance program required by subpart D, but is specifically used for purposes of complying with the exemption for market making-related activity.

measures in a way that takes into account the risk profile and market making activity of the particular trading desk.

As noted in the discussion pertaining to the underwriting exemption,[117] banking entities that do not have significant trading assets and liabilities can incur significant costs to establish, implement, maintain, and enforce the compliance program requirements contained in the 2013 final rule. In some instances, those costs may be disproportionate to the banking entity's trading activity and risk. Accordingly, eliminating the compliance program requirements for banking entities that do not have significant trading assets and liabilities may reduce costs that are passed on to investors and increase liquidity without materially impacting the rule's ability to ensure that the objectives set forth in section 13 of the BHC Act are satisfied.[118]

The Agencies request comment on the proposed revisions to the exemption for market making-related activities compliance program requirement. In particular, the Agencies request comment on the following questions:

Question 97. Would the proposed tiered compliance approach based on a banking entity's trading assets and liabilities appropriately balance the costs and benefits for banking entities that do not have significant trading assets and liabilities? Why or why not?

Question 98. Should the Agencies make specific changes to simplify and streamline the compliance requirements of the exemption for market making-related activities for banking entities with significant trading assets and liabilities? If so, how?

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[117] *See supra* Part III.B.2 of this SUPPLEMENTARY INFORMATION section.

[118] Under the proposal, the compliance program requirements that are specific for the purposes of complying with the exemption for market making-related activities in § __.4(b) would remain unchanged for banking entities with significant trading assets and liabilities, although the requirements related to limits for each trading desk would be moved (but not modified) into new § __.4(b)(6)(i) as part of the proposed presumption of compliance.

Question 99. Do commenters agree with the proposal to have the market making exemption specific compliance program requirements apply only to banking entities with significant trading assets and liabilities? Why or why not?

Question 100. In addition to the proposed changes to the market making exemption, are there any technical corrections the Agencies should make to § __.4(b), such as to eliminate redundant or duplicative language or to correct or refine certain cross-references? If so, please explain.

g. Loan-related swaps

The Agencies have received inquiries—typically from smaller banking entities that are not subject to the market risk capital rule and are not required to register as dealers—as to the treatment of certain swaps entered into with a customer in connection with a loan ("loan-related swap").[119] These loan-related swaps are financial instruments under the 2013 final rule and would also be financial instruments under the proposal. In addition, if the proposed accounting prong of the trading account definition is adopted, any derivative transaction would constitute proprietary trading pursuant to the definition of "trading account" if it were recorded at fair value on a recurring basis under applicable accounting standards. The Agencies believe it is likely that loan-related swaps would be considered proprietary trading on this basis. Accordingly, for the transaction to be permissible, a banking entity would need to rely on an applicable exclusion from the definition of proprietary trading or exemption in the implementing regulations.

[119] In the case of national banks, a loan-related swap is considered to be a customer-driven derivatives transaction. *See* 12 U.S.C 24 (Seventh). *See also* OCC, Activities Permissible for National Banks and Federal Savings Associations, Cumulative (Oct. 2017), *available at* https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-activities-permissible-october-2017.pdf.

In a loan-related swap transaction, a banking entity enters into a swap with a customer in connection with a customer's loan and contemporaneously offsets the swap with a third party. The swap with the loan customer is directly related to the terms of the customer's loan, such as a term loan, revolving credit facility, or other extension of credit. A common example of a loan-related swap begins with a banking entity offering a loan to a customer. The banking entity seeks to make a floating-rate loan to reduce interest rate risk, but the customer would prefer a fixed-rate loan. To achieve the desired result, the banking entity makes a floating-rate loan to the customer and contemporaneously or nearly contemporaneously enters into an interest rate swap with the same customer and an offsetting swap with another counterparty. As a result, the customer receives economics similar to a fixed-rate loan. The banking entity has offset its market risk associated with the customer-facing swap but retains counterparty risk from both swaps.

The inquiries received by the Agencies have asked whether the loan-related swap and the offsetting hedging swap would be permissible under the exemption for market making related activities.[120] In particular, some banking entities enter into these swaps relatively infrequently and, as a result, have asked whether such activity could satisfy the requirement of the exemption in the 2013 final rule that the trading desk using the exemption routinely stands ready to purchase and sell the relevant type of financial instrument, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the type of financial instrument.[121]

[120] The Agencies note that "market making" for purposes of the 2013 final rule, including for this proposal, is limited to the context of the 2013 final rule and is not applicable to any other rule, the federal securities laws, or in any other context outside of the 2013 final rule.

[121] *See* 2013 final rule § __.4(b)(2)(i); 79 FR at 5595-5597.

The Agencies understand that a banking entity's decision to enter into loan-related swaps tends to be situational and dependent on changes in market conditions, as well as the interaction of a number of factors specific to the banking entity, such as the nature of the customer relationship. Under certain market conditions and with certain types of customers, the frequency and use of loan-related swaps may be infrequent, or the frequency may change over time as conditions change. It also may be the case that a banking entity, particularly smaller banking entities, may enter into a limited number of loan-related swaps in one quarter and then not execute another such swap for a year or more. Accordingly, for these swaps it may be appropriate to apply the market making exemption by focusing on the characteristics of the relevant market. For purposes of the exemption, the relevant market may be a market with minimal demand, such as a market with a customer base that demands, for example, only a few loan-related swaps in a year.[122] The Agencies therefore request 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.[123] For example, a banking entity could meet the requirement to routinely stand ready to make a market in loan-related swaps in the context of its customer base and the relevant market if it is willing and available to engage in loan-related swap transactions

[122] *See, e.g.*, 79 FR at 5596 (". . . the Agencies continue to recognize that market makers in highly illiquid markets may trade only intermittently *or at the request of particular customers*, which is sometimes referred to as trading by appointment.") (emphasis added).

[123] The Agencies understand that, for the reasons described in this section, loan-related swaps present a particular challenge for smaller banking entities that are neither subject to the market risk rule nor registered as dealers. On the other hand, such swaps typically do not present the same challenges for banking entities that are subject to the market risk rule or are registered as dealers because the availability of the market-making exemption is apparent.

with its loan customers to meet the customers' needs in respect of one or more loans entered into with such banking entity throughout market cycles and as such customers' needs change.

In addition, the Agencies note that a banking entity may also infrequently enter into loan-related swaps in both directions because of how those swaps are commonly used by market participants. For example, providing a floating to fixed swap is common in connection with a floating rate loan (as described in the example above), but the reverse (i.e., seeking to convert from a fixed rate to a floating rate) is much less common. Accordingly, the Agencies request comment on whether loan-related swaps should be permitted under the market-making exemption if the banking entity stands ready to make a market in both directions whenever a customer makes an appropriate request, but in practice primarily makes a market in the swaps in one direction because of how the swaps are used.[124]

The Agencies are also considering whether it would be appropriate to exclude loan-related swaps from the definition of proprietary trading for some banking entities or to permit the activity pursuant to an exemption from the prohibition on proprietary trading other than market making. For example, possible additions or alternatives could include a new exclusion in § __.3(d) or a new exemption in § __.6 pursuant to the Agencies' exemptive authority under section 13(d)(1)(J) of the BHC Act. In particular, the Agencies request comment regarding a specific option that would add an exclusion in § __.3(d), which would specify that "proprietary trading" under § __3 does not include the purchase or sale of related swaps by a banking entity in a transaction in which the banking entity purchases (or sells) a swap with a customer and contemporaneously sells (or purchases) an offsetting derivative in connection with a loan or open

[124] This section's focus on market making is provided solely for purpose of the proposal's implementation of section 13 of the BHC Act and does not affect a banking entity's obligation to comply with additional or different requirements under applicable securities, derivatives, banking, or other laws.

credit facility between the banking entity and the customer, if the rate, asset, liability or other notional item underlying the swap with the customer is, or is directly related to, a financial term of the loan or open credit facility with the customer (including, without limitation, the loan or open credit facility's duration, rate of interest, currency or currencies, or principal amount) and the offsetting swap is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks of the swap(s) with the customer.

In considering any of these alternatives, the Agencies request comment on what parameters would be appropriate for the exclusion or exemption and what conditions should be considered to address any concerns about whether such an exclusion or exemption could be too broad.

Question 101. Is it appropriate to treat loan-related swaps as permissible under the market making exemption if a banking entity stands ready to enter into such swaps upon request by a customer, but enters into such swaps on an infrequent basis due to the nature of the demand for such swaps? Why or why not?

Question 102. Should a banking entity standing ready to transact in either direction on behalf of customers in such swaps be eligible for the market making exemption if, as a practical matter, it more frequently encounters demand on one side of the market and less frequently encounters demand on the other side for such products? Why or why not?

Question 103. Is the scenario described above for the treatment of loan-related swaps workable? If not, why not? Are there alternative approaches that would be more effective and consistent with the statute?

Question 104. Should the Agencies exclude loan-related swaps from the definition of proprietary trading under § __.3? Would including loan-related swaps within the definition of

the "trading account" or "proprietary trading" be consistent with the statutory definition of trading account? Why or why not?

Question 105. In the alternative, should the Agencies provide an exclusion for such loan-related swaps under § __.6? What would be the benefits or drawbacks of each approach? How would permitting such loan-related swaps pursuant to the Agencies' authority under section 13(d)(1)(J) of the BHC Act promote and protect the safety and soundness of banking entities and the financial stability of the United States? If an exclusion or permitted activity is adopted, should the Agencies limit which banking entities may use the exclusion or permitted activity, and what conditions, if any, should be placed on the types, volume, or other characteristics of the loan-related swaps and the related activity?

Question 106. How should loan-related swaps be defined? What parameters should be used to assess which swaps meet the definition?

Question 107. Should other types of swaps also be addressed in the same manner? For example, should the Agencies provide further guidance, or include in any exclusion or exemption other end-user customer driven swaps used by the customer to hedge commercial risk?

h. Market making hedging

During implementation of the 2013 final rule, the Agencies received a number of inquiries regarding the circumstances under which banking entities could elect to comply with market making risk management provisions permitted in § __.4(b) or alternatively the risk-mitigating hedging requirements under § __.5. These inquiries generally related to whether a trading desk could treat an affiliated trading desk as a client, customer, or counterparty for purposes of the market making exemption's 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.

Each trading desk engaging in a transaction with an affiliated trading desk that meets the definition of proprietary trading must rely on one of the exemptions of section 13 of the BHC Act and the 2013 final rule in order for the transaction to be permissible. 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. The Agencies request 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 risk limits or reasonably expected near-term demand levels under the market making exemption.

The Agencies also request comment as to whether each desk should be permitted to treat swaps executed between the desks as permitted market making-related activities of one or both desks if the swap does not cause the relevant desk to exceed its applicable limits and if the swap is entered into and maintained in accordance with the compliance requirements applicable to the desk, without treating the affiliated desk as a client, customer, or counterparty for purposes of establishing or increasing its limits. This approach would be 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 would be intended to permit efficient internal risk management strategies within the limits established for each desk.

The Agencies are also requesting 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 risk management exemption available to the market making desk. 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 does not independently satisfy the requirements of the market making exemption with respect to the transaction, it would be permitted to rely on the market making exemption 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 established in accordance with § __.4(b)(2)(iii); and (ii) the resulting risk mitigating position is attributed to the market making desk's financial exposure (and not the affiliated unit's financial exposure) and is included in the market making desk's daily profit and loss calculation. If the affiliated unit establishes a risk-mitigating position for the market making desk on its own accord (i.e., not at the direction of the market making desk) or if the risk-mitigating position is included in the affiliated unit's financial exposure or daily profit and loss calculation, then the affiliated unit may still be able to comply with the requirements of the risk-mitigating hedging exemption pursuant to § __.5 for such activity.

The Agencies request comment on the issues identified above. In particular, the Agencies request comment on the following questions:

Question 108. Should the Agencies clarify the ability of banking entities to engage in hedging transactions directly related to market making positions, including multi-desk market making hedging, regardless of which desk undertakes the hedging trades?

Question 109. Have banking entities found that certain restrictions on market making hedging activities under the final rule impede the ability of banking entities to effectively and efficiently engage in such hedging transactions? If so, what specific requirements have proved to be the most problematic?

Question 110. How effective are the existing restrictions on market making hedging activities at reducing risks within a banking entity's investment portfolio? Please explain.

Question 111. Should the Agencies permit banking entities to include affiliate hedging transactions in determining the reasonably expected near-term demand of customers, clients, and counterparties, and in establishing internal risk limits? Why or why not?

Question 112. Would the changes separately proposed to § __.5 of the 2013 final rule, or other changes to § __.5, eliminate the need for the additional interpretations described above, for example, because a banking entity could more easily conduct these activities in accordance with the requirements of § __.5?

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

a. Section __.5 of the 2013 Final Rule

Section 13(d)(1)(C) provides an exemption for risk-mitigating hedging activities that are designed to reduce the specific risks to a banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings. Section __.5 of the 2013 final rule implements section 13(d)(1)(C) of the BHC Act.

Section __.5 of the 2013 final 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. 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 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.[125] In addition, the hedging activity itself must meet specified conditions; for example, at inception, it 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.[126] Finally, § __.5 establishes certain documentation requirements with respect to the purchase or sale of financial instruments made in reliance of the risk-mitigating exemption under certain circumstances.[127]

b. Proposed Amendments to Section __.5

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

Section __.5(b)(1)(iii) of the 2013 final rule requires a correlation analysis as part of the broader analysis of whether a hedging position, technique, or strategy (1) may reasonably be expected to reduce or otherwise significantly mitigate the specific risks being hedged, and (2) demonstrably reduces or otherwise significantly mitigates the specific risks being hedged.

In adopting the 2013 final rule, the Agencies indicated that they expected the banking entity to undertake a correlation analysis that will provide a strong indication of whether a potential hedging position, strategy, or technique will or will not demonstrably reduce the risk it

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

[126] *See* 2013 final rule § __.5(b)(2).

[127] *See* 2013 final rule § __.5(c).

is designed to reduce. The nature and extent of the correlation analysis undertaken would be dependent on the facts and circumstances of the hedge and the underlying risks targeted. If sufficient correlation cannot be demonstrated, then the Agencies expected that such analysis would explain why not and also how the proposed hedging position, technique, or strategy was designed to reduce or significantly mitigate risk and how that reduction or mitigation can be demonstrated.

In the course of implementing § __.5 of the 2013 final rule, the Agencies have become aware of practical difficulties with the correlation analysis requirement. In particular, banking entities have communicated that the correlation analysis requirement can add delays, costs, and uncertainty, and have questioned the extent to which the required correlation analysis helps to ensure the accuracy of hedging activity or compliance with the requirements of section 13 of the BHC Act.

During implementation, the Agencies have observed that a banking entity may sometimes develop or modify its hedging activities as the risks it seeks to hedge are occurring, and the banking entity may not have enough time to undertake a complete correlation analysis before it needs to put the hedging transaction in place to fully hedge against the risks as they arise. In other cases, the hedging activity, while designed to reduce risk as required by the statute, may not be practical if delays or compliance costs resulting from undertaking a correlation analysis outweigh the benefits of performing the analysis. In addition, the extent to which two activities are correlated and will remain correlated into the future can vary significantly from one position, strategy, or technique to another. Assessing whether a particular hedge is sufficiently correlated to satisfy the correlation requirement of § __.5(b)(1)(iii) may be difficult, especially if that assessment must be justified after the hedge is entered into (when information that may not have

been available earlier may become relevant). Given this uncertainty, banking entities may be hesitant to undertake a risk-mitigating hedge out of concern of inadvertently violating the regulation because the hedge did not satisfy one of the requirements.

Based on the implementation experience of the Agencies and public feedback, the Agencies are proposing to remove the correlation analysis requirement for risk-mitigating hedging activities. The Agencies anticipate that removing this correlation analysis requirement would avoid the uncertainties described above without significantly impacting the conditions that risk-mitigating hedging activities must meet in order to qualify for the exemption. The Agencies also note that section 13 of the BHC Act does not specifically require this 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 . . . "[128] The 2013 final 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 Section __.5(b)(2)(iv)(B)**

Similarly, the requirement in § __.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. As noted above, the statute instead requires that the hedge be designed to reduce or otherwise significantly mitigate specific risks. The Agencies believe that this is effective for addressing the relevant risks.

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

[128] 12 U.S.C. 1851(d)(1)(C).

Agencies recognize that in some circumstances, it may be difficult for banking entities to know with sufficient certainty that a potential hedging activity being considered will continuously demonstrably reduce or significantly mitigate an identifiable risk after it is implemented. For example, unforeseeable changes in market conditions, event risk, sovereign risk, and other factors that cannot be known in advance could reduce or eliminate the otherwise intended hedging benefits. In these events, 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. In such cases, a banking entity may determine not to enter into what would otherwise be an effective hedge of foreseeable risks out of concern that the banking entity may not be able to effectively comply with the continuing hedging or mitigation requirement if unforeseen risks occur. Therefore, the proposal would remove the "demonstrably reduces or otherwise significantly mitigates" specific risk requirement from § __.5(b)(1)(iv)(B).[129]

iii. **Reduced Compliance Requirements for Banking Entities that do not have Significant Trading Assets and Liabilities for Section __.5(b) and (c)**

Consistent with the proposed changes relating to the scope of the requirements for banking entities that do not have significant trading assets and liabilities, the Agencies have reassessed the requirements in § __.5(b) and § __.5(c) for banking entities that do not have significant trading assets and liabilities. For these firms, the Agencies are proposing to eliminate the requirements for a separate internal compliance program for risk-mitigating hedging under

[129] For the same reasons, the Agencies are proposing to revise § __.13(a) of the 2013 final rule (relating to permitted risk-mitigating hedging activities involving acquisition or retention of an ownership interest in a covered fund) to remove the references to covered fund ownership interests acquired or retained by the banking entity "demonstrably" reducing or otherwise significantly mitigating the specific, identifiable risks to the banking entity described in that section.

§ __.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 those activities in § __.5(c). These requirements are overly burdensome and complex for banking entities with moderate trading assets and liabilities. In general, the Agencies expect that banking entities without significant trading assets and liabilities are less likely to engage in the types of trading activities and hedging strategies that would necessitate these additional compliance requirements.

Given these considerations, it appears that removing the requirements for banking entities that do not have significant trading assets and liabilities to comply with the requirements of § __.5(b) and § __.5(c) is unlikely to materially increase risks to the safety and soundness of the banking entity or U.S. financial stability. Therefore, the Agencies are proposing to eliminate and modify these requirements for banking entities that do not have significant trading assets and liabilities. In place of those requirements, new § __.5(b)(2) of the proposal would require 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 anticipate that these tailored 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. In connection with these proposed changes, the proposal also includes conforming changes to § __.5(b)(1) and § __.5(c) of the final

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)

Section __.5(c) of the 2013 final rule requires enhanced documentation for hedging activity conducted under the risk-mitigating hedging exemption if the hedging is not conducted by the specific trading desk establishing or responsible for the underlying positions, contracts, or other holdings, the risks of which the hedging activity is designed to reduce.[130] The 2013 final rule also requires enhanced documentation for hedges established to hedge aggregated positions across two or more desks. The 2013 final rule recognizes that a trading desk may be responsible for hedging aggregated positions of that desk and other desks, business units, or affiliates. In that case, the trading desk putting on the hedge is at least one step removed from some of the positions being hedged. Accordingly, the 2013 final rule provides that the documentation requirements in § __.5(c) apply if a trading desk is hedging aggregated positions that include positions from more than one trading desk.[131]

The 2013 final rule also requires enhanced documentation for hedges established by the specific trading desk establishing or directly responsible for the underlying positions, contracts, or other holdings, the risks of which the hedge is designed to reduce, if the hedge is effected through a financial instrument, 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 that the trading desk may use for hedging.[132] The Agencies note that this documentation

[130] *See* 2013 final rule § __.5(c)(1)(i).

[131] *See* 2013 final rule § __.5(c)(1)(iii)

[132] *See* 2013 final rule § __.5(c)(1)(ii)

requirement does not apply to hedging activity conducted by a trading desk in connection with the market making-related activities of that desk or by a trading desk that conducts hedging activities related to the other permissible trading activities of that desk so long as the hedging activity is conducted in accordance with the compliance program for that trading desk.

For banking entities that have significant trading assets and liabilities, the proposal would retain the enhanced documentation requirements for the hedging transactions identified in § __.5(c)(1) to permit evaluation of the activity. While this documentation requirement results in certain more extensive compliance efforts (as acknowledged by the Agencies when the 2013 final rule was adopted),[133] the Agencies continue to believe this requirement serves an important role to prevent evasion of the requirements of section 13 of the BHC Act and the 2013 final rule.

However, based on the Agencies' experience during the first several years of implementation of the 2013 final 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 repetitively. In those instances, the regulatory purpose for the documentation requirements of § __.5(c) of the 2013 final rule, to permit subsequent evaluation of the hedging activity and prevent evasion, is much less relevant. In weighing the significantly reduced regulatory and supervisory relevance of additional documentation of common hedging trades against the complexity of complying with the enhanced documentation requirements, it appears 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

[133] 79 FR at 5638-39.

more efficient and potentially improve the timeliness of important risk-mitigating hedging activity, the effectiveness of which can be time sensitive.

Accordingly, the Agencies are proposing a new paragraph (c)(4) in § __.5 that would eliminate the enhanced documentation requirement for hedging activities that meets certain conditions. In excluding a trading desk's common hedging instruments from the enhanced documentation requirements in § __.5(c), the Agencies seek to distinguish those financial instruments that are commonly used for hedging activities and require the banking entity to have in place appropriate limits so that less common or unusual levels of hedging activity would still be subject to the enhanced documentation requirements. Accordingly, the proposal would provide that 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. In addition, under the proposal, at the time of the purchase or sale of the financial instruments, the related hedging activity would need to comply with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument, which would be required to be appropriate for the size, types, and risks of the hedging activities commonly undertaken by the trading desk; the financial instruments purchased and sold by the trading desk for hedging activities; and the levels and duration of the risk exposures being hedged. 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 proposal. The Agencies would expect that a banking entity's 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 request comment on the proposed revisions to § __.5 regarding permitted risk-mitigating hedging activities. In particular, the Agencies request comment on the following questions:

Question 113. What factors, if any, should the Agencies consider in determining whether to remove the requirement that a correlation analysis must be used to determine whether a hedging position, technique, or strategy reduces or otherwise significantly mitigates the specific risk being hedged?

Question 114. Is the Agencies' assessment of the complexities of the correlation analysis requirement across the spectrum of hedging activities accurate? Why or why not?

Question 115. How does the requirement to undertake a correlation analysis impact a banking entity's decision on whether to enter into different types of hedges?

Question 116. How does the correlation analysis requirement affect the timing of hedging activities?

Question 117. Does the current requirement that a hedge must demonstrably reduce or otherwise significantly mitigate specific risks lead banking entities to decline to enter into hedging transactions that would otherwise be designed to reduce or otherwise significantly mitigate specific risks arising in connection with identified positions, contracts, or other holdings of the banking entity? If so, under what circumstances?

Question 118. Would reducing the compliance requirements of § __.5(b) and § __.5(c) for banking entities that do not have significant trading assets and liabilities reduce compliance costs and increase certainty for these banking entities?

Question 119. Would the proposed reductions in the compliance requirements for risk-mitigating hedging activities by banking entities that do not have significant trading assets and liabilities increase materially the risks to the safety and soundness of the banking entity or U.S. financial stability? Why or why not?

Question 120. Would the proposed exclusion from the enhanced documentation requirements for trading desks that hedge risk of other desks under the circumstances described make risk-mitigating hedging activities more efficient and timely? Why or why not? Should any of the existing documentation requirements be retained for firms without significant trading assets and liabilities? Are there any hedging documentation requirements applicable in other contexts (e.g., accounting) that could be leveraged for the purposes of this requirement? How would the proposed exclusion from the enhanced documentation requirements impact both internal and external compliance and oversight of a banking entity?

Question 121. With respect to the proposed exclusion from enhanced documentation for trading desks that hedge risk of other desks under certain circumstances, are the requirements for a pre-approved list of financial instruments and pre-approved hedging limits reasonable? Should those requirements be modified, expanded, or reduced? If so, how? Should the Agencies provide greater clarity for determining which financial instruments are "commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold" for inclusion on the pre-approved list? Similarly, should the Agencies provide greater clarity for determining pre-approved hedging limits?

Question 122: The Agencies have proposed using accounting principles as part of the definition of trading account. Should the Agencies similarly use accounting principles to refer to risk-mitigated hedging activity? For example, should the Agencies provide an exemption for

hedging activity that is accounted for under the provisions of ASC 815 (Derivatives and Hedging)? Why or why not? Should the Agencies require entities that engage in risk-mitigating hedging activity measure hedge effectiveness? Why or why not?

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

Section 13(d)(1)(H) of the BHC Act[134] permits certain foreign banking entities to engage in proprietary trading that occurs solely outside of the United States (the foreign trading exemption).[135] The statute does not define when a foreign banking entity's trading occurs "solely outside of the United States."

a. Permitted Trading Activities of a Foreign Banking Entity

The 2013 final rule includes several conditions on the availability of the foreign trading exemption. Specifically, in addition to limiting the exemption to foreign banking entities where the purchase or sale is made pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act,[136] the 2013 final rule provides that the foreign trading exemption is available only if:

(i) The banking entity engaging as principal in the purchase or sale (including any personnel of the banking entity or its affiliate that arrange, negotiate, or execute such purchase or

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[134] 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).

[135] This section's discussion of the concept of "solely outside of the United States" is provided solely for purposes of the proposal'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.

[136] 12 U.S.C. 1843(c)(9), (13). *See* 2013 final rule § __.6(e)(1)(i) and (ii).

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;

(v) The purchase or sale is not conducted with or through any U.S. entity,[137] other than:

(A) A purchase or sale with the foreign operations of a U.S. entity, if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation or execution of such purchase or sale.

The Agencies also exercised their authority under section 13(d)(1)(J)[138] to allow the following types of purchases or sales to be conducted with a U.S. entity:

[137] "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 final rule § __.6(e)(4).

[138] 12 U.S.C. 1851(d)(1)(J).

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

(C) A purchase or sale through an unaffiliated market intermediary, provided the purchase or sale is conducted anonymously (i.e., each party to the purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale) 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.

The proposal would modify the requirements of the 2013 final rule relating to the foreign trading exemption in a number of ways. Specifically, the proposal would retain the first three requirements of the 2013 final rule, with a modification to the first requirement, and would remove the last two requirements of § __.6(e)(3). As a result, § __.6(e)(3), as modified by the proposal, would require 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 maintain 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 retain the 2013 final rule's requirement that the purchase or sale, including any transaction arising from a related risk-mitigating hedging transaction, is not accounted for as principal at the U.S. operations of the foreign banking entity. The proposal would, however, modify the first requirement relative to the 2013 final rule, to replace the 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 not located in the United States. Under the proposed approach, for purposes of section 13 of the BHC Act and the implementing regulations, the focus of the requirement would be on whether the banking entity that engages in the purchase or sale as principal (including any relevant personnel) is located in the United States. The purpose of this modification is to make clear that some limited involvement by U.S. personnel (e.g., arranging or negotiating) would be consistent with this exemption so long as the principal bearing the risk of a purchase or sale is outside the United States. The proposed modifications would permit a foreign banking entity to engage in a purchase or sale under 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 and the implementing regulations. The proposal would also eliminate the following two requirements from § __.6(e), which are referred to as the "financing prong" and the "counterparty prong," respectively, in the discussion that follows:

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 purchase or sale is not conducted with or through any U.S. entity, other than:

A purchase or sale with the foreign operations of a U.S. entity, if no personnel of such U.S. entity that are located in the United States are involved in the arrangement, negotiation or execution of such purchase or sale.

A purchase or sale with an unaffiliated market intermediary acting as principal, provided the purchase or sale is promptly cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty; or

A purchase or sale through an unaffiliated market intermediary, provided the purchase or sale is conducted anonymously (i.e. each party to the purchase or sale is unaware of the identity of the other party(ies) to the purchase or sale) 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 final rule, foreign banking entities have communicated to the Agencies that these requirements have unduly limited their ability to make use of the statutory exemption for proprietary trading and have resulted in an impact on foreign banking entities' operations outside of the United States that these banking entities believe is broader than necessary to achieve compliance with the requirements of section 13 of the BHC Act. In response to these concerns, the Agencies are proposing to remove the financing prong and the counterparty prong, which would focus the key requirements of this exemption on the principal actions and risk of the transaction. In addition, the proposal would remove the financing prong

to address concerns that the fungibility of financing has made this requirement difficult to apply in practice in certain circumstances to determine whether 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 amend the foreign trading 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 are designed to require that the principal risks of the transaction occur and remain solely outside of the United States. For example, the exemption would continue to provide that the purchase or sale, including any transaction arising from risk-mitigating hedging related to the instruments purchased or sold, may not be accounted for as principal directly or indirectly on a consolidated basis by any U.S. branch or affiliate.

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 are proposing 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 in order 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.

As a result, the Agencies propose to remove the counterparty prong. The proposal would focus 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 is intended to align with the statute's definition of "proprietary trading" as "engaging as principal for the trading account of the banking entity."[139] Consistent with that approach, the focus of the proposed approach would be on the activities of a foreign banking entity as principal in the United States. The statute exempts the trading of foreign banking entities that is conducted "solely" outside the United States. Under the proposal, the relevant inquiry would focus on whether the principal risk of the transaction is located or held outside of the United States and the location of the trading decision and banking entity acting as principal. The proposal would remove the requirements of § __.6(e)(3) that are less directly relevant to these considerations.

Information provided by foreign banking entities has demonstrated that few trading desks of foreign banking entities have utilized the foreign trading exemption in practice. This information has raised concerns that the current requirements for the exemption may be overly restrictive of permitted activities. Accordingly, the proposal would modify the exemption under

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

the 2013 final rule to make the requirements more workable, so that it may be available to foreign banking entities trading solely outside the United States.

The Agencies request comment as to whether the proposed modifications to the foreign trading exemption would result in disadvantages for U.S. banking entities competing with foreign banking entities. The statute contains an exemption to allow foreign banking entities to engage in trading activity that is 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. economy. The Agencies believe that this means that the prohibition on proprietary trading is intended make U.S. banking entities safer and stronger, and reduce risks to U.S. financial stability, and that the foreign operations of foreign banking entities should not be subject to the prohibition on proprietary trading for their activities overseas. The proposal would implement this distinction with respect to transactions that occur outside of the United States 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. Under the statute and the rulemaking framework, U.S. banking entities would be able to continue trading activities that are consistent with the statute and regulation, including permissible market-making, underwriting, and risk-mitigating hedging activities as well as other types of trading activities such as trading on behalf of customers. U.S. banking entities are permitted to engage in these trading activities as exemptions from the general prohibition on proprietary trading under the statute. Moreover, and consistent with the statute, the proposal seeks to streamline and reduce the requirements of several of these key exemptions to make them more workable and

available in practice to all banking entities subject to section 13 of the BHC Act and the implementing regulations.[140]

Consistent with the 2013 final rule, the exemption under the proposal would not exempt 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, 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 final 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 final rule, would not impose 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 be on each party subject to section 13 to ensure that it is conducting its activities in accordance with section 13 and the implementing regulations.

The proposal's exemption for trading of foreign banking entities outside the United States could potentially give 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 or other exemptions under the rule. This competitive

[140] At the same time, however, the Agencies recognize the possibility that there may also be risks to U.S. banking entities and the U.S. economy as a result of allowing foreign banking entities to conduct a broader range of activities within the United States. For example, and as discussed above, the Agencies are requesting comment on whether the proposal would give foreign banking entities a competitive advantage over U.S. banking entities with respect to identical trading activity in the United States.

disparity in turn could create a significant potential for regulatory arbitrage. In this respect, the Agencies seek to mitigate this concern through other changes in the proposal; for example, U.S. banking entities would continue to be able to engage in all of the activities permitted under the 2013 final rule and the proposal, including the simplified and streamlined requirements for market-making and risk-mitigating hedging and other types of trading activities. The proposal's modifications therefore in general seek 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 request comment on the proposal's revised approach to implementing the foreign trading exemption. In particular, the Agencies request comment on the following questions:

Question 123. Is the proposal's implementation of the foreign trading exemption appropriate and effectively delineated? If not, what alternative would be more appropriate and effective?

Question 124. Are the proposal's provisions regarding when an activity will be considered to have occurred solely outside the United States for purposes of the foreign trading exemption effective and sufficiently clear? If not, what alternative would be clearer and more effective? Should any requirements be modified or removed? If so, which requirements and why? Should additional requirements be added? If so, what requirements and why? For example, should the financing prong or the counterparty prong be retained or modified rather than eliminated? Why or why not? Do the proposed modifications effectively focus the foreign trading exemption on the principal actions and risk of the transaction and ensure that the

principal risk remains solely outside the United States? Are there any other conditions the Agencies should include in the foreign trading and foreign fund exemptions to address the possibility that risks associated with foreign trading or covered fund activities could flow into the U.S. financial system through financing for those activities coming from U.S. branches of affiliates, without raising the same compliance difficulties banking entities have experienced with the current financing prong?

Question 125. What effects do commenters believe the proposed modifications to the foreign trading exemption, particularly with respect to trading with U.S. entities, would have with respect to the safety and soundness of banking entities and U.S. financial stability? Would the proposed modifications allow for risks to aggregate in the United States based on activity of foreign banking entities? For example, what effects would removal of the counterparty prong have for U.S. financial market liquidity, and what consequences could such effects have for the safety and soundness of banking entities and U.S. financial stability? Could the proposal be further modified, consistent with statutory requirements, to better promote and protect the safety and soundness of banking entities and U.S. financial stability? Please explain.

Question 126. What impact could the proposal have on a foreign banking entity's ability to trade in the United States? Should any additional requirements of the 2013 final rule be removed? Why or why not? If so, which requirements and why? Should any of the requirements of the 2013 final rule that the Agencies are proposing to eliminate be retained? Why or why not? If so, which requirements and why?

Question 127. Does the proposal's approach raise competitive equity concerns for U.S. banking entities? If so, in what ways? Would the proposed modifications allow for foreign entities to access the U.S. markets without commensurate regulation? How would this impact

competition? Would this disadvantage U.S. entities? Would the proposed revisions to the 2013 final rule's exemptions for market making, underwriting, and risk-mitigating hedging and new exclusions contained in this proposal help to mitigate these concerns? How could such concerns be addressed while effectively implementing this statutory exemption?

Question 128. The proposed approach would eliminate the requirement in the 2013 final rule that trading performed pursuant to the foreign trading exemption not be conducted with or through any U.S. entity, subject to certain exceptions.[141] Would eliminating this requirement give foreign banking entities a competitive advantage over U.S. banking entities with respect to identical trading activity in the United States? For example, would eliminating this requirement give foreign banking entities a competitive advantage over U.S. banking entities with respect to permitted market-making or underwriting activities? Why or why not? Are there ways that any such competitive disparities could potentially be mitigated or eliminated in a manner consistent with the statute? If so, please explain. Would the proposed approach create opportunities for certain banking entities to avoid the operation of the rule in ways that would frustrate the purposes of the statute? If so, how?

Question 129. The proposed approach would eliminate the requirement in the 2013 final rule that personnel of the banking entity who arrange, negotiate, or execute a purchase or sale under the foreign trading exemption be located outside the United States.[142] Should this requirement be removed? Why or why not? Would eliminating this restriction, thereby allowing foreign banking entities to perform certain core market-facing activities in the United States and with U.S. customers, create competitive disparities between foreign banking entities and U.S. banking entities? Please explain. Are there ways that any such competitive disparities could

[141] *See* § __.6(e)(3).

[142] *See* §§ __.6(e)(3)(i) and __.6(e)(3)(v)(A).

potentially be mitigated or eliminated in a manner consistent with the statute? If so, please explain. Would the proposed approach create opportunities for banking entities to avoid the operation of the rule in ways that would frustrate the purposes of the statute? If so, how?

Question 130. Instead of removing the requirement that any personnel of the banking entity that arrange, negotiate, or execute a purchase or sale be located outside of the United State, should the Agencies provide definitions or guidance on these terms, for example, similar to definitions and guidance adopted or issued by the SEC and CFTC under Title VII of the Dodd-Frank Act and implementing regulations? Are there any other modifications that would be more appropriate?

C. Subpart C—Covered Fund Activities and Investments

1. Section __.10: Prohibition on Acquisition or Retention of Ownership Interests in, and Certain Relationships with, a Covered Fund

a. Prohibition Regarding Covered Fund Activities and Investments

As noted above and except as otherwise permitted, section 13(a)(1)(B) of the BHC Act generally prohibits a banking entity from acquiring or retaining any ownership interest in, or sponsoring, a covered fund.[143] Section 13(d) of the BHC Act contains certain exemptions to this prohibition. Subpart C of the 2013 final rule implements these and other provisions of section 13 related to covered funds. Specifically, § __.10(a) of the 2013 final rule establishes the scope of the covered fund prohibitions and § __.10(b) of the 2013 final rule defines a number of key terms, including "covered fund." Section __.10(c) of the 2013 final rule tailors the definition of "covered fund" by providing particular exclusions. The covered fund definition, taking into account the particular exclusions, is central to the operation of subpart C of the 2013 final rule because it specifies the types of entities to which the prohibition contained in § __.10(a) of the

[143] *See* 12 U.S.C. 1851(a)(1)(B).

2013 final rule applies, unless the relevant activity is specifically permitted under an available exemption contained elsewhere in subpart C of the final rule.

In the 2013 final rule, the Agencies adopted a tailored definition of "covered fund" that covers issuers of the type that would be investment companies but for section 3(c)(1) or 3(c)(7) of the Investment Company Act[144] with exclusions for certain specific types of issuers. The Agencies designed the exclusions to focus the covered fund definition on vehicles used for the investment purposes that the Agencies believed were the target of section 13 of the BHC Act.[145] The definition of "covered fund" under the 2013 final rule also includes certain funds organized and offered outside of the United States to address the potential for circumvention of the restrictions in section 13 through foreign fund structures and certain types of commodity pools for which a registered commodity pool operator has elected to claim the exemption provided by section 4.7 of the CFTC's regulations or investor limitations apply.[146] In the preamble to the 2013 final rule, the Agencies stated their belief that the definition was consistent with the words,

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

[145] *See* 79 FR at 5671.

[146] *Id*. In the preamble to the 2013 final rule, the Agencies also expressed their intent to exercise the statutory anti-evasion authority provided in section 13(e) of the BHC Act and other prudential authorities in order to address instances of evasion. The 2013 final rule permits the Agencies to jointly determine to include within the definition of "covered fund" any fund excluded from that definition, and this authority may be exercised to address instances of evasion. *See* 2013 final rule § __.10(c).

structure, purpose, and legislative history of section 13 of the BHC Act.[147] In particular, the Agencies stated that the purpose of section 13 appears to be to limit the involvement of banking entities in high-risk proprietary trading, as well as their investment in, sponsorship of, and other connections with, entities that engage in investment activities for the benefit of banking entities, institutional investors, and high-net worth individuals.[148] Further, the Agencies indicated that section 13 permitted them to tailor the scope of the definition to funds that engage in the investment activities contemplated by section 13 (as opposed, for example, to vehicles that merely serve to facilitate corporate structures).[149] Tailoring the scope of the definition was intended to allow the Agencies to avoid any unintended results that might follow from a definition that was inappropriately imprecise.[150]

The Agencies request comment on whether the 2013 final rule's covered fund definition effectively implements the statute and is appropriately tailored to identify funds that engage in the investment activities contemplated by section 13. The Agencies also request comment on whether the definition has been inappropriately imprecise and, if so, whether that has led to any unintended results.

i. **Covered fund "base definition" – section__.10(b)**

[147] *See* 79 FR at 5670. Section 13(h)(2) provides that: "the terms 'hedge fund' and 'private equity fund' mean an issuer that would be an investment company as defined in the [Investment Company Act] (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, *or* such similar funds as the [Agencies] may, by rule, as provided in subsection (b)(2), determine." *See* 12 U.S.C. 1851(h)(2) (emphasis added).

[148] *See* 79 FR at 5670.

[149] *See id*. at 5666.

[150] In adopting the 2013 final rule, the Agencies referred to legislative history that suggested that Congress may have foreseen that its base definition could lead to unintended results and might be overly broad, too narrow, or otherwise off the mark. *See id*. at 5670-71.

In considering whether to further tailor the covered fund definition, the Agencies seek comment in this section on the 2013 final rule's general approach to defining the term "covered fund" and the 2013 final rule's "base definition" of covered fund, that is, the definition as provided in § __.10(b) before applying the exclusions found in § __.10(c), as well as alternatives to this base definition.[151] In the sections that follow the Agencies request comment on exclusions from the covered fund definition that relate to specific areas of concern expressed to the Agencies.

Question 131. The Agencies adopted in the 2013 final rule a unified definition of "covered fund" rather than having separate definitions for "hedge fund" and "private equity fund" because the statute defines "hedge fund" and "private equity fund" without differentiation. Instead of retaining a unified definition of "covered fund," should the Agencies separately define "hedge fund" and "private equity fund" or define "covered fund" as a "hedge fund" or "private equity fund"? Would such an approach more effectively implement the statute? If so, how should the Agencies define these terms and why? Alternatively, the Agencies request comment below as to whether the Agencies should provide exclusions from the covered fund base definition for an issuer that does not share certain characteristics commonly associated with a hedge fund or private equity fund. If the Agencies were to define the terms "hedge fund" and "private equity fund," would it be more effective to do so with an exclusion from the covered fund definition for issuers that do not resemble "hedge funds" and "private equity funds"?

Question 132. In the 2013 final rule, the Agencies tailored the scope of the definition to funds that engage in the investment activities contemplated by section 13. Does the 2013 final rule's definition of "covered fund" effectively include funds that engage in those investment

[151] *See* 2013 final rule § __.10(b)(1)(i), (ii), and (iii).

activities? Are there funds that are included in the definition of "covered fund" that do not engage in those investment activities? If so, what types of funds, and should the Agencies modify the definition to exclude them? Are there funds that engage in those investment activities but are not included in the definition of "covered fund"? If so, what types of funds and should the Agencies modify the definition to include them? If the Agencies should modify the definition, how should it be modified?

Question 133. In the preamble to the 2013 final rule, the Agencies stated that tailoring the scope of the definition of "covered fund" would allow the Agencies to avoid unintended results that might follow from a definition that is "inappropriately imprecise."[152] Has the final definition been "inappropriately imprecise" in practice? If so, how? Should the Agencies modify the base definition to be more precise? If so, how? Alternatively or in addition to modifying the base definition, could the Agencies modify or add any exclusions to make the definition more precise, as discussed below?

Question 134. The 2013 final rule's definition of "covered fund" includes certain funds organized and offered outside of the United States with respect to a U.S. banking entity that sponsors or invests in the fund in order to address structures that might otherwise allow circumvention of the restrictions of section 13. Does this "foreign covered fund" provision effectively address those circumvention concerns? If not, should the Agencies modify this provision to address those circumvention concerns more directly or in some other way? If so, how?

Question 135. The 2013 final rule's definition of "covered fund" includes certain commodity pools in order to address structures that might otherwise allow circumvention of the

[152] *See* 79 FR at 5670-71.

restrictions in section 13. In adopting this "covered commodity pool" provision, the Agencies sought to take a tailored approach that is designed to accurately identify those commodity pools that are similar to issuers that would be investment companies as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act, consistent with section 13(h)(2) of the BHC Act. Does this "covered commodity pool" provision effectively address those circumvention concerns? If not, should the Agencies modify this provision to address those circumvention concerns more directly or in some other way? If so, how? Has the covered commodity pool provision been effective in including in the covered fund base definition those commodity pools that are similar to issuers that would be investment companies but for section 3(c)(1) or 3(c)(7)? Has it been under- or over-inclusive? What kinds of commodity pools have been included in or excluded from the covered fund base definition and are these inclusions or exclusions appropriate? If the covered commodity pool provision is under- or over-inclusive, what changes should the Agencies make and how would those changes be more effective?

Question 136. What kinds of compliance and other costs have banking entities incurred in analyzing whether particular issuers are covered funds and implementing compliance programs for covered fund activities? Has the breadth of the base definition raised particular compliance challenges? Have the 2013 final rule's exclusions from the covered fund definition helped to reduce compliance costs or provided greater certainty as to the scope of the covered fund definition?

Question 137. If the Agencies modify the covered fund base definition in whole or in part, would banking entities expect to incur significant costs or burdens in order to become compliant? That is, after having established compliance, trading, risk management, and other systems predicated on the 2013 final rule's covered fund definition, what are the kinds of costs

and any other burdens and their magnitude that banking entities would experience if the Agencies were to modify the covered fund base definition?

Question 138. The Agencies understand that banking entities have already expended resources in reviewing a wide range of issuers to determine if they are covered funds, as defined in the 2013 final rule. What kinds of costs and burdens would banking entities and others expect to incur if the Agencies were to modify the covered fund base definition to the extent any modifications were to require banking entities to reevaluate issuers to determine if they meet any revised covered fund definition? To what extent would modifying the covered fund base definition require banking entities to reevaluate issuers that a banking entity previously had determined are not covered funds? Would any costs and burdens be justified to the extent the Agencies more effectively tailor the covered fund definition to focus on the concerns underlying section 13? Could any costs and burdens be mitigated if the Agencies further tailored or added exclusions from the covered fund definition or developed new exclusions, as opposed to changing the covered fund base definition?

Question 139. To what extent do the proposed modifications to other provisions of the 2013 final rule affect the impact of the scope of the covered fund definition? For example, as described below, the Agencies are proposing to eliminate some of the additional, covered-fund specific limitations that apply under the 2013 final rule to a banking entity's underwriting, market making, and risk-mitigating hedging activities. As another example, the Agencies are requesting comment below about whether to incorporate into § __.14's limitations on covered transactions the exemptions provided in section 23A of the Federal Reserve Act ("FR Act") and the Board's Regulation W. To the extent commenters have concerns regarding the breadth of the covered fund definition, would these concerns be addressed or mitigated by the changes the

Agencies are proposing to the other covered fund provisions or on which the Agencies are seeking comment?

ii. **Particular exclusions from the covered fund definition**

As discussed above, the 2013 final rule contains exclusions from the base definition of "covered fund" that tailor the covered fund definition. The Agencies designed these exclusions to avoid any unintended results that might follow from a definition of "covered fund" that was inappropriately imprecise. In this section, the Agencies request comment on whether to modify certain existing exclusions from the covered fund definition. The Agencies also request comment on whether to provide new exclusions in order to more effectively tailor the definition. Finally, with respect to all of the potential modifications the Agencies discuss in this section, the Agencies seek comment as to the potential effect of the other changes the Agencies are proposing today to the covered fund provisions and on additional changes on which the Agencies seek comment. That is, would these proposed changes address in whole or in part any concerns about the breadth of the covered fund definition?

iii. **Foreign public funds**

The 2013 final rule generally excludes from the definition of "covered fund" any issuer that is organized or established outside of the United States and the ownership interests of which are (i) authorized to be offered and sold to retail investors in the issuer's home jurisdiction and (ii) sold predominantly through one or more public offerings outside of the United States.[153] The

[153] *See* 2013 final rule § __.10(c)(1); *See also* 79 FR at 5678 ("For purposes of this exclusion, the Agencies note that the reference to retail investors, while not defined, should be construed to refer to members of the general public who do not possess the level of sophistication and investment experience typically found among institutional investors, professional investors or high net worth investors who may be permitted to invest in complex investments or private placements in various jurisdictions. Retail investors would therefore be expected to be entitled to the full protection of securities laws in the home jurisdiction of the fund, and the Agencies would expect a fund authorized to sell ownership interests to such retail investors to be of a type

Agencies stated in the preamble to the 2013 final rule that they generally expect that an offering is made predominantly outside of the United States if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States.[154]

The 2013 final rule places an additional condition on a U.S. banking entity's ability to rely on the FPF exclusion with respect to any FPF it sponsors.[155] The FPF exclusion is only available to a U.S. banking entity with respect to a foreign fund sponsored by the U.S. banking entity if, in addition to the requirements discussed above, the fund's ownership interests are sold predominantly to persons other than the sponsoring banking entity, affiliates of the issuer and the sponsoring banking entity, and employees and directors of such entities.[156] The Agencies stated in the preamble to the 2013 final rule that, consistent with the Agencies' view concerning whether an FPF has been sold predominantly outside of the United States, the Agencies generally expect that an FPF will satisfy this additional condition if 85 percent or more of the

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that is more similar to a [RIC] rather than to a U.S. covered fund."); 2013 final rule § __.10(c)(1)(iii) (defining the term "public offering" for purposes of this exclusion to mean a "distribution," as defined in § __.4(a)(3) of subpart B, of securities in any jurisdiction outside the United States to investors, including retail investors, provided that, the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available).

[154] 79 FR at 5678.

[155] Although the discussion of this condition generally refers to U.S. banking entities for ease of reading, the condition also applies to foreign affiliates of a U.S. banking entity. *See* 2013 final rule § __.10(c)(1)(ii) (applying this limitation "[w]ith respect to a banking entity that is, or is controlled directly or indirectly by a banking entity that is, located in or organized under the laws of the United States or of any State and any issuer for which such banking entity acts as sponsor").

[156] *See* 2013 final rule § __.10(c)(1)(ii).

fund's interests are sold to persons other than the sponsoring U.S. banking entity and the specified persons connected to that banking entity.[157]

In adopting the FPF exclusion, the Agencies' view was that it is appropriate to exclude these funds from the "covered fund" definition because they are sufficiently similar to U.S. RICs.[158] The Agencies also expressed the view that the additional condition applicable to U.S. banking entities is designed to treat FPFs consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States, while also seeking to limit the possibility for evasion through foreign public funds.[159]

The Agencies request comment on all aspects of the FPF exclusion, including whether the exclusion is effective in identifying foreign funds that may be sufficiently similar to RICs and permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States, as the Agencies contemplated in adopting this exclusion. As reflected in the detailed questions that follow, the Agencies seek comment on a range of possible ways to modify this exclusion, including: (i) whether the Agencies could

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[157] 79 FR at 5678.

[158] *Id.* ("The requirements that a foreign public fund both be authorized for sale to retail investors and sold predominantly in public offerings outside of the United States are based in part on the Agencies' view that foreign funds that meet these requirements generally will be sufficiently similar to [RICs] such that it is appropriate to exclude these foreign funds from the covered fund definition.")

[159] *Id.* ("This additional condition reflects the Agencies' view that the foreign public fund exclusion is designed to treat foreign public funds consistently with similar U.S. funds and to limit the extraterritorial application of section 13 of the BHC Act, including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States. The exclusion is not intended to permit a U.S. banking entity to establish a foreign fund for the purpose of investing in the fund as a means of avoiding the restrictions imposed by section 13.").

simplify or omit certain of the exclusion's conditions—including those not applicable to excluded RICs — while still identifying funds that should be excluded and addressing the possibility for evasion through the Agencies' broad anti-evasion authority; (ii) whether the exclusion's conditions requiring a fund to be authorized for sale to retail investors in the issuer's home jurisdiction and sold predominantly in public offerings outside of the United States should be retained and, if so, whether the Agencies should modify or clarify these conditions; and (iii) whether the additional conditions for U.S. banking entities with respect to the FPFs they sponsor are appropriate. Specifically, in considering whether to further tailor the FPF exclusion, the Agencies seek comment below on the following:

Question 140. Are foreign funds that satisfy the current conditions in the FPF exclusion sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? Why or why not? Are there foreign funds that cannot satisfy the exclusion's conditions but that are nonetheless sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? If so, how should the Agencies modify the exclusion's conditions to permit these funds to rely on it? Conversely, are there foreign funds that satisfy the exclusion's conditions but are not sufficiently similar to RICs such that it is not appropriate to exclude these funds from the covered fund definition? If so, how should the Agencies modify the exclusion's conditions to prohibit these funds from relying on it? Conversely, are changes to the FPF exclusion necessary given the other changes the Agencies are proposing today and on which the Agencies seek comment?

Question 141. RICs are excluded from the covered fund definition regardless of whether their ownership interests are sold in public offerings or whether their ownership interests are sold predominantly to persons other than the sponsoring banking entity, affiliates of the issuer and the

sponsoring banking entity, and employees and directors of such entities. Is such an exclusion appropriate? Why or why not?

Question 142: As discussed above, the Agencies designed the FPF exclusion to identify foreign funds that are sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition, but included additional conditions not applicable to RICs in part to limit the possibility for evasion of the 2013 final rule. Do FPFs present a heightened risk of evasion that justifies these additional conditions, as they currently exist or with any of the modifications on which the Agencies request comment below? Why or why not?

Question 143: As an alternative, should the Agencies address concerns about evasion through other means, such as the anti-evasion provisions in § __.21 of the 2013 final rule?[160] The 2013 final rule includes recordkeeping requirements designed to facilitate the Agencies' ability to monitor banking entities' investments in FPFs to ensure that banking entities do not use the exclusion for FPFs in a manner that functions as an evasion of section 13. Specifically, under the 2013 final rule, a U.S. banking entity with more than $10 billion in total consolidated assets is required to document its investments in foreign public funds, broken out by each FPF and each foreign jurisdiction in which any FPF is organized, if the U.S. banking entity and its affiliates' ownership interests in FPFs exceed $50 million at the end of two or more consecutive calendar quarters.[161] The Agencies are proposing to retain these and other covered fund

[160] Section __.21 of the 2013 final rule provides in part that whenever an Agency finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or the 2013 final rule, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or the 2013 final rule, the Agency may take any action permitted by law to enforce compliance with section 13 of the BHC Act and the 2013 final rule, including directing the banking entity to restrict, limit, or terminate any or all activities under the 2013 final rule and dispose of any investment.

[161] *See* 2013 final rule § __.20(e).

recordkeeping requirements with respect to banking entities with significant trading assets and liabilities.

Alternatively, would retaining specific provisions designed to address anti-evasion concerns, whether as they currently exist or modified, provide greater clarity as to the scope of foreign funds excluded from the definition and avoid uncertainty that could result from a less prescriptive exclusion?

Question 144. One condition of the FPF exclusion is that the fund must be "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction." The Agencies understand that banking entities generally interpret the 2013 final rule's reference to the issuer's "home jurisdiction" to mean the jurisdiction in which the issuer is organized. Is this condition helpful in identifying FPFs that should be excluded from the covered fund definition? Why or why not? The Agencies provided guidance regarding the 2013 final rule's current reference to "retail investors."[162] Has this provided sufficient clarity? Additionally, as discussed below, the 2013 final rule contains an additional condition requiring that to meet the exclusion, a fund must sell ownership interests predominantly through one or more public offerings outside the United States. As an alternative to requiring that the fund be authorized to sell interests to retail investors, should the Agencies instead require that the fund be authorized to sell interests in a "public offering"?

Question 145. The Agencies understand that some funds may be formed under the laws of one non-U.S. jurisdiction, but offered to retail investors in another. For example, Undertakings for Collective Investment in Transferable Securities ("UCITS") funds and investment companies with variable capital, or SICAVs, may be domiciled in one jurisdiction in

[162] *See supra* note 153.

the European Union, such as Ireland or Luxembourg, but may be offered and sold in one or more other E.U. member states. In this case a foreign fund could be authorized for sale to retail investors, as contemplated by the FPF exclusion, but fail to satisfy this condition. Should the Agencies modify this condition to address this situation? If so, how?

Question 146. Should the Agencies, for example, modify the condition to omit any reference to the fund's "home jurisdiction" and instead provide, for example, that the fund must be authorized to offer and sell ownership interests to retail investors in "the primary jurisdiction" in which the issuer's ownership interests are offered and sold? Would that or a similar approach effectively identify funds that are sufficiently similar to RICs, including funds that are formed under the laws of one jurisdiction and offered and sold in another? For purposes of determining the primary jurisdiction, would the Agencies need to define the term "primary" or a similar term to provide sufficient clarity? If so, how should the Agencies define this or a similar term? Are there funds for which it could be difficult to identify a "primary" jurisdiction? Does the condition need to refer to a "primary jurisdiction," or would it be sufficient to require that the fund be authorized to offer and sell ownership interests to retail investors in "any jurisdiction" in which the issuer's ownership interests are offered and sold? Should the exclusion focus on whether the fund is authorized to make a public offering in the primary, or any, jurisdiction in which it is offered and sold as a proxy for whether it is authorized for sale to retail investors?

If the Agencies were to make a modification like the one described immediately above, should the exclusion retain the reference to the issuer's "home" jurisdiction? For example, should the Agencies modify this condition to require that the fund be "authorized to offer and sell ownership interests to retail investors in the primary jurisdiction in which the issuer's ownership interests are offered and sold," without any reference to the home jurisdiction?

Would this modification be effective, or does the exclusion need to retain a reference to an issuer the ownership interests of which are authorized for sale to retail investors in the home jurisdiction, as well as the primary jurisdiction in which the issuer's ownership interests are offered and sold? Why? If the rule retained a reference to authorization in the fund's home jurisdiction, would this raise concerns if a fund were authorized to be sold to retail investors in the fund's home jurisdiction, but was not sold in that jurisdiction and instead was sold to institutions or other non-retail investors in a different jurisdiction in which the fund was not authorized to sell interests to retail investors or to make a public offering? Are there other formulations the Agencies should make to identify foreign funds that are authorized to offer and sell their ownership interests to retail investors? Which formulations and why?

Question 147. Under the 2013 final rule, a foreign public fund's ownership interests must be sold predominantly through one or more "public offerings" outside of the United States, in addition to the condition discussed above that the fund must be authorized for sale to retail investors. One result of this "public offerings" condition is that a fund that is authorized for sale to retail investors—including a fund authorized to make a public offering—cannot rely on the exclusion if the fund does not in fact offer and sell ownership interests in public offerings. Some foreign funds, like some RICs, may be authorized for sale to retail investors but may choose to offer ownership interests to high-net worth individuals or institutions in non-public offerings. Do commenters believe it is appropriate that these foreign funds cannot rely on the FPF exclusion? Should the Agencies further tailor the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering, as discussed above, rather than whether the fund interests were actually sold in a public offering? Would the investor protection and other regulatory requirements that would

tend to make foreign funds similar to a U.S. registered fund generally be a consequence of a fund's authorization for sale to retail investors or authorization to make a public offering?

If a fund is authorized to conduct a public offering in a non-U.S. jurisdiction, would the fund be subject to all of the regulatory requirements that apply in that jurisdiction for funds intended for broad distribution, including to retail investors, even if the fund is not in fact sold in a public offering to retail investors?

Question 148. The 2013 final rule defines the term "public offering" for purposes of this exclusion to mean a "distribution" (as defined in § __.4(a)(3) of the 2013 final rule) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that (i) the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; (ii) the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and (iii) the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available.[163] If the Agencies were to modify the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering—rather than whether the fund's interests were actually sold in a public offering—should the Agencies retain some or all of the conditions included in the 2013 final rule's definition of the term "public offering"? For example, should the Agencies retain the requirement that a public offering is one that does not restrict availability to investors having a minimum level of net worth or net investment assets; and/or the requirement that an FPF file or submit, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available? Would either of these two conditions, either alone or

[163] *See* 2013 final rule § __.10(c)(1)(iii).

together, help to identify foreign funds that are sufficiently similar to RICs? Why or why not? Is the reference to a "distribution" (as defined in § __.4(a)(3) of the 2013 final rule) effective? Should the Agencies modify the reference to a "distribution" to address instances in which a fund's ownership interests generally are sold to retail investors in secondary market transactions, as with exchange-traded funds, for example? Should the definition of "public offering" also take into account whether a fund's interests are listed on an exchange?

Question 149. The public offering definition provides in part that the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets. Are there jurisdictions that permit offerings that would otherwise meet the definition of a public offering but that restrict availability to investors having a minimum level of net worth or net investment assets or that otherwise restrict the types of investors who can participate?

Conversely, should the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States? Would a foreign fund that actually sells ownership interests in public offerings outside of the United States tend to provide greater information to the public or be subject to additional regulatory requirements than a fund that is authorized to conduct a public offering but offers and sells its ownership interests in non-public offerings?

Question 150. If the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States, should the Agencies retain the requirement that the fund's ownership interests must be sold "predominantly" through one or more such offerings? Why or why not? As mentioned above, the Agencies stated in the preamble to the 2013 final rule that they generally expect a fund's offering would satisfy this requirement if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States. Has

this guidance been helpful in identifying FPFs that should be excluded, if the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States?

Question 151. The Agencies understand that some banking entities have faced compliance challenges in determining whether 85 percent or more of the fund's interests are sold to investors that are not residents of the United States. Where foreign funds are listed on a foreign exchange, for example, it may not be feasible to obtain sufficient information about a fund's owners to make these determinations. The Agencies understand that banking entities also have experienced difficulties in obtaining sufficient information about a fund's owners in some cases where the foreign fund is sold through intermediaries. What sorts of compliance and other costs have banking entities incurred in developing and maintaining compliance systems to track foreign public funds' compliance with this condition? To the extent that commenters have experienced these or other compliance challenges, how have commenters addressed them? Have funds failed to qualify for the FPF exclusion because of this condition? Which kinds of funds and why? Do commenters believe that these funds should nonetheless be treated as FPFs? Why? If the Agencies retain this condition, should they reduce the required percentage of a fund's ownership interests that must be sold to investors that are not residents of the United States? Which percentage would be appropriate? Should the percentage be more than 50 percent, for example? Would a lower percentage mitigate the compliance challenges discussed above? If the Agencies do not retain the condition that an FPF must be sold predominantly through one or more public offerings outside of the United States, should the Agencies impose any limitations on the extent to which the fund can be offered in private offerings in the United States?

Question 152. The 2013 final rule places an additional condition on a U.S. banking entity's ability to rely on the FPF exclusion with respect to any FPF it sponsors: the fund's ownership interests must be sold predominantly to persons other than the sponsoring banking entity and certain persons connected to that banking entity. Has this additional condition been effective in identifying FPFs that should be excluded from the covered fund definition? Has it been effective in permitting U.S. banking entities to continue their asset management businesses outside of the United States while also limiting the opportunity for evasion of section 13? Conversely, has this additional condition resulted in the compliance challenges discussed above in connection with the Agencies' view that a fund generally is sold "predominantly" in public offerings outside of the United States if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States? The Agencies understand that determining whether the employees and directors of a banking entity and its affiliates have invested in a foreign fund has been particularly challenging for banking entities because the 2013 final rule defines the term "employee" to include a member of the immediate family of the employee.[164] Is there a more direct way to define the term "employee" to mitigate the compliance challenges but still be effective in limiting the opportunity for evasion of section 13? If so, how? Should a revised definition specify who is included in an employee's immediate family for this purpose? Should a revised definition exclude immediate family members? If so, why?

Question 153. What other aspects of the conditions for FPFs have resulted in compliance challenges? Has the condition that FPFs be sold predominantly through public offerings outside of the United States resulted in U.S. banking entities, including their foreign affiliates and subsidiaries, determining not to sponsor new FPFs because of concerns about compliance

[164] *See* 2013 final rule § __.2(j).

challenges and costs? If the Agencies retain this additional condition, should they reduce the required percentage of a fund's ownership interests sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity? Which percentage would be appropriate? Would a lower percentage mitigate the compliance challenges discussed above? Are there other conditions that might better serve the same purpose but reduce the challenges presented by this condition? One effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but can own up to 25 percent of a RIC after the seeding period.[165] Is this disparate treatment appropriate? Another effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but a foreign banking entity can own up to 25 percent of an FPF that it sponsors. Is this disparate treatment appropriate?

Question 154. Following the adoption of the 2013 final rule, staffs of the Agencies provided responses to certain FAQs, including whether an entity that is formed and operated pursuant to a written plan to become an FPF would receive the same treatment as an entity formed and operated pursuant to a written plan to become a RIC or BDC.[166]

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[165] The limitation on a banking entity's investment in a U.S. registered fund under the 2013 final rule results from the definition of "banking entity." If a banking entity owns, controls, or has power to vote 25 percent or more of any class of voting securities of another company, including a U.S. registered fund after a seeding period, that other company will itself be a banking entity under the 2013 final rule.

[166] All the Agencies have published all FAQs on each of their public websites. *See* Frequently Asked Question number 5, *available at* https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#5; Covered Fund Definition, *available at* https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm; Foreign Public Fund Seeding Vehicles, *available at* https://www.fdic.gov/regulations/reform/volcker/faq/foreign.html; Foreign Public Fund Seeding Vehicles, *available at* https://occ.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-rule-implementation-faqs.html#foreign; Foreign Public Fund Seeding Vehicles, *available at*

The staffs observed that the 2013 final rule explicitly excludes from the covered fund definition an issuer that is formed and operated pursuant to a written plan to become a RIC or BDC in accordance with the banking entity's compliance program as described in § __.20(e)(3) of the 2013 final rule and that complies with the requirements of section 18 of the Investment Company Act. The staffs observed that the 2013 final rule does not include a parallel provision for an issuer that will become a foreign public fund. The staffs stated that they do not intend to advise the Agencies to treat as a covered fund under the 2013 final rule an issuer that is formed and operated pursuant to a written plan to become a qualifying foreign public fund. The staffs observed that any written plan would be expected to document the banking entity's determination that the seeding vehicle will become a foreign public fund, the period of time during which the seeding vehicle will operate as a seeding vehicle, the banking entity's plan to market the seeding vehicle to third-party investors and convert it into an FPF within the time period specified in § __.12(a)(2)(i)(B) of the 2013 final rule, and the banking entity's plan to operate the seeding vehicle in a manner consistent with the investment strategy, including leverage, of the seeding vehicle upon becoming a foreign public fund. Has the staffs' position facilitated consistent treatment for seeding vehicles that operate pursuant to a plan to become an FPF as that provided for seeding vehicles that operate pursuant to plans to become RICs or BDCs? Why or why not? Should the Agencies amend the 2013 final rule to implement this or a different approach for seeding vehicles that will become foreign public funds? What other approaches should the Agencies take and why? Should the Agencies amend the 2013 final rule to require seeding vehicles that operate pursuant to a written plan to become an FPF to include in such written plan the same or different types of documentation as the documentation required of

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https://www.cftc.gov/sites/default/files/idc/groups/public/@externalaffairs/documents/file/volckerrule_faq060914.pdf.

seeding vehicles that operate pursuant to plans to become RICs or BDCs? If different types of documentation should be required of seeding vehicles that will become foreign public funds, why would those different types of documentation be appropriate? Would requiring those different types of documentation impose costs or burdens on the issuers that are greater or less than the costs and burdens imposed on issuers that will become RICs or BDCs?

iv. **Family wealth management vehicles**

Some families manage their wealth by establishing and acquiring ownership interests in "family wealth management vehicles." Family wealth management vehicles take a variety of legal forms, including limited liability companies, limited partnerships, other pooled investment vehicles, and trusts. The structures in which these vehicles operate vary in complexity, ranging from simple standalone arrangements covering a single beneficiary to complex multi-tier structures intended to benefit multiple generations of family members. In some cases, these vehicles have been in existence for more than 100 years while in other cases, they are nascent entities with little to no operating history. The Agencies are aware of no set of consistent standards that govern the characteristics of family wealth management vehicles or the manner in which they operate.

Because family wealth management vehicles might hold assets that meet the definition of "investment securities"[167] in the Investment Company Act, they may be investment companies

[167] Section 3(a)(2) of the Investment Company Act defines "investment securities" to include all securities except Government securities, securities issued by employees' securities companies, and majority-owned subsidiaries of the owner which are not investment companies, and are not relying on the exception from the definition of investment company in section 3(c)(1) or 3(c)(7). Section 3(a)(1)(C) defines an investment company, in part, as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of each such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

that either need to register as such or otherwise rely on an exclusion from the definition of investment company. Many family wealth management vehicles rely on the exclusions provided by sections 3(c)(1) or 3(c)(7) of the Investment Company Act. Family wealth management vehicles that would be investment companies but for sections 3(c)(1) or 3(c)(7) will therefore be covered funds unless they satisfy the conditions for one of the 2013 final rule's exclusions from the covered fund definition. Concerns regarding family wealth management vehicles were raised to the Agencies following the adoption of the 2013 final rule, which does not provide an exclusion from the covered fund definition specifically designed to address these vehicles.

Family wealth management vehicles also often maintain accounts and advisory arrangements with banking entities. These banking entities may provide a range of services to family wealth management vehicles, including investment advice, brokerage execution, financing, and clearance and settlement services. Family wealth management vehicles structured as trusts for the benefit of family members also often appoint banking entities, acting in a fiduciary capacity, as trustees for the trusts.

Section __.14 of the 2013 final rule provides, in part, that no banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers the fund under § __.11 of the 2013 final rule, may enter into a transaction with the covered fund that would be a "covered transaction," as defined in section 23A of the FR Act.[168] To the extent that a family wealth management vehicle is a covered fund, then § __.14 would apply. Specifically, if a banking entity provides services, such as advisory services, that trigger application of § __.14, the banking entity would be prohibited from providing the family wealth management vehicle a

[168] *See* 2013 final rule § __.14(a).

range of customer-facing banking services that involve "covered transactions." Examples of these prohibited covered transactions include intraday or short-term extensions of credit in connection with the clearance and settlement of securities transactions executed by the banking entity for the family wealth management vehicle.

The Agencies are not proposing changes in the status of family wealth management vehicles in the proposal, but are seeking comment on their reliance on exclusions in the Investment Company Act, whether or not they should be excluded from the definition of covered fund, the role of banking entities with respect to family wealth management vehicles, and the potential implications of changes in their status under the 2013 final rule. In considering whether to address the status of family wealth management vehicles, the Agencies seek comment on the following:

Question 155. Do family wealth management vehicles typically rely on the exclusions in sections 3(c)(1) or 3(c)(7) under the Investment Company Act? Are there other exclusions from the definition of "investment company" in the Investment Company Act upon which family wealth management vehicles can rely? What have been the additional challenges for family wealth management vehicles and the banking entities that service them when considering whether these vehicles rely on the exclusions in sections 3(c)(1) or 3(c)(7)?

Question 156. Should the Agencies exclude family wealth management vehicles from the definition of "covered fund"? If so, how should the Agencies define "family wealth management vehicle," and is this the appropriate terminology? What factors should the Agencies consider to distinguish a family wealth management vehicle from a hedge fund or private equity fund, as contemplated by the statute, given that these vehicles may utilize identical structures and pursue comparable investment strategies? Would any of the definitions in rule

202(a)(11)(G)-1 under the Investment Advisers Act of 1940 effectively define family wealth management vehicle? Should the Agencies, for example, define a family wealth management vehicle to mean an issuer that would be a "family client," as defined in rule 202(a)(11)(G)-1(d)(4)? What modifications to that definition would be appropriate for purposes of any exclusion from the covered fund definition? For example, that definition defines a "family client," in part, to include any company wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients, which include any family member or former family member. That rule defines a "family member" to mean "all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members." Would this approach to defining a "family member" be appropriate in the context of an exclusion from the covered fund definition? Why or why not and, if not, what other approaches should the Agencies take? Are there any family wealth management vehicles organized or managed outside of the United States that raise similar concerns? If so, should the Agencies define these family wealth management vehicles differently?

Question 157. Would an exclusion for family wealth management vehicles create any opportunities for evasion, for example, by allowing a banking entity to structure investment vehicles in a manner to evade the restrictions of section 13 on covered fund activities? Why or why not? If so, how could such concerns be addressed? Please explain.

Question 158. What services do banking entities provide to family wealth management vehicles? Below, the Agencies seek comment on whether section 14 of the implementing regulation should incorporate the exemptions within section 23A of the FR Act and the Board's Regulation W. Would this approach permit banking entities to provide these services to family wealth management vehicles? Are there other ways in which the Agencies should address the issue of banking entities being prohibited from providing services to family wealth vehicles that would be covered transactions?

Question 159. Are there any similar vehicles outside of the family wealth management context that pose similar issues?

v. **Fund Characteristics**

As the Agencies stated in the preamble to the 2013 final rule, an alternative to the 2013 final rule's approach of defining a covered fund would be to reference fund characteristics. In the preamble to the 2013 final rule, the Agencies stated that a characteristics-based definition could be less effective than the approach taken in the 2013 final rule as a means to prohibit banking entities, either directly or indirectly, from engaging in the covered fund activities limited or proscribed by section 13.[169] The Agencies also stated that a characteristics-based approach could require more analysis by banking entities to apply those characteristics to every potential covered fund on a case-by-case basis and could create greater opportunity for evasion. Finally, the Agencies stated that although a characteristics-based approach could mitigate the costs associated with an investment company analysis, depending on the characteristics, such an approach could result in additional compliance costs in some cases to the extent banking entities

[169] *See* 79 FR at 5671.

would be required to implement policies and procedures to prevent issuers from having characteristics that would bring them within the covered fund definition.

As the Agencies consider whether to further tailor the covered fund definition, the Agencies invite commenters' views and request comment on whether it may be appropriate to exclude from the definition of "covered fund" entities that lack certain characteristics commonly associated with being a hedge fund or a private equity fund:

Question 160. Should the Agencies exclude from the definition of "covered fund" entities that lack certain enumerated traits or factors of a hedge fund or private equity fund? If so, what traits or factors should be incorporated and why? For instance, the SEC's Form PF defines the terms "hedge fund" and "private equity fund," as described below.[170] Would it be appropriate to exclude from the definition of "covered fund" an entity that does not meet either of the Form PF definitions of "hedge fund" and "private equity fund"? If the Agencies were to take this approach, should we, for example, modify the 2013 final rule to provide that an issuer is excluded from the covered fund definition if that issuer is neither a "hedge fund" nor a "private equity fund," as defined in Form PF, or should the Agencies incorporate some or all of the substance of the definitions in Form PF into the 2013 final rule?

Question 161. If the Agencies were to incorporate the substance of the definitions of hedge fund and private equity fund in Form PF, should the Agencies make any modifications to these definitions for purposes of the 2013 final rule? Also, Form PF is designed for reporting by funds advised by SEC-registered advisers. Would any modifications be needed to have the

[170] *See* Form PF, Glossary of Terms. Form PF uses a characteristics-based approach to define different types of private funds. A "private fund" for purposes of Form PF is any issuer that would be an investment company, as defined in section 3 of the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of that Act. Form PF defines the following types of private funds: hedge funds, private equity funds, liquidity funds, real estate funds, securitized asset funds, venture capital funds, and other private funds. *See infra* at note 167.

characteristics-based exclusion apply to funds not advised by SEC-registered advisers, in particular foreign funds with non-U.S. advisers not registered with the SEC?

Question 162. Form PF defines "hedge fund" to mean any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration). If the Agencies were to incorporate these provisions as part of a characteristics-based exclusion, should any of these provisions be modified? If so, how? Additionally, Form PF's definition of the term "hedge fund" provides that, solely for purposes of Form PF, any commodity pool is categorized as a hedge fund.[171] If the Agencies were to define the term "hedge fund" based on the definition in Form PF, should the term include only those commodity pools that come within the "hedge fund" definition without regard to this clause in the Form PF definition that treats every commodity pool as a hedge fund for purposes of Form PF? Why or why not?

Question 163. By contrast, Form PF primarily defines "private equity fund" not by affirmative characteristics, but as any private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund, as those terms are defined in Form

[171] Form PF defines "commodity pool" by reference to the definition in section 1a(10) of the Commodity Exchange Act. *See* 7 U.S.C. 1a(10).

PF,[172] and that does not provide investors with redemption rights in the ordinary course. If the Agencies were to provide a characteristics-based exclusion, should the Agencies do so by incorporating the definitions of these other private funds? If so, should the Agencies modify such definitions, and if so, how? Alternatively, rather than referencing the definition of private equity fund in Form PF in a characteristics-based exclusion, the Agencies could design their own definition of a private equity fund based on traits and factors commonly associated with a private equity fund. For example, the Agencies understand that private equity funds commonly (i) have restricted or limited investor redemption rights; (ii) invest in public and non-public companies through privately negotiated transactions resulting in private ownership of the business; (iii) acquire the unregistered equity or equity-like securities of such companies that are illiquid as there is no public market and third party valuations are not readily available; (iv) require holding investments long-term; (v) have a limited duration of ten years or less; and (vi) realize returns on investments and distribute the proceeds to investors before the anticipated expiration of the fund's duration. Are there other traits or factors the Agencies should incorporate if the Agencies were to provide a characteristics-based exclusion? Should any of these traits or factors be omitted?

Question 164. A venture capital fund, as defined in rule 203(l)-1 under the Advisers Act, is not a "private equity fund" or "hedge fund," as those terms are defined in Form PF. In the

[172] Form PF defines "liquidity fund" to mean any private fund that seeks to generate income by investing in a portfolio of short term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors; "real estate fund" to mean any private fund that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course and that invests primarily in real estate and real estate related assets; "securitized asset fund" to mean any private fund whose primary purpose is to issue asset backed securities and whose investors are primarily debt-holders; and "venture capital fund" to mean any private fund meeting the definition of venture capital fund in rule 203(l)-1 under the Investment Advisers Act of 1940.

preamble to the 2013 final rule, the Agencies explained why they believed that the statutory language of section 13 did not support providing an exclusion for venture capital funds from the definition of "covered fund."[173] If the Agencies were to adopt a characteristics-based exclusion based on the definition of private equity fund in Form PF, should the Agencies specify that venture capital funds are private equity funds for purposes of this rule so that venture capital funds would not be excluded from the covered fund definition? Do commenters believe that this approach would be consistent with the statutory language of section 13?

Question 165. The Agencies request that commenters advocating for a characteristics-based exclusion explain why particular characteristics are appropriate, what kinds of funds and what kinds of investment strategies or portfolio holdings might be excluded by the commenters' suggested approach, and why that would be appropriate.

Question 166. If the Agencies were to provide a characteristics-based exclusion, should it exclude only funds that have none of the enumerated characteristics? Alternatively, are there

[173] *See* 79 FR at 5704 ("The final rule does not provide an exclusion for venture capital funds. The Agencies believe that the statutory language of section 13 does not support providing an exclusion for venture capital funds from the definition of covered fund. Congress explicitly recognized and treated venture capital funds as a subset of private equity funds in various parts of the Dodd-Frank Act and accorded distinct treatment for venture capital fund advisers by exempting them from registration requirements under the Investment Advisers Act. This indicates that Congress knew how to distinguish venture capital funds from other types of private equity funds when it desired to do so. No such distinction appears in section 13 of the BHC Act. Because Congress chose to distinguish between private equity and venture capital in one part of the Dodd-Frank Act, but chose not to do so for purposes of section 13, the Agencies believe it is appropriate to follow this Congressional determination.") (footnotes omitted). Section 13 also provides an extended transition period for "illiquid funds," which section 13 defines, in part, as a hedge fund or private equity fund that, as of May 1, 2010, was principally invested in, or was invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments. Congress appears to have contemplated that covered funds would include funds principally invested in venture capital investments.

any circumstances where a fund should be able to rely on a characteristics-based exclusion if it had some, but not most, of the characteristics?

Question 167. Would a characteristics-based exclusion present opportunities for evasion? Should the Agencies address any concerns about evasion through other means, such as the anti-evasion provisions in § __.21 of the 2013 final rule, rather than by including a broader range of funds in the covered fund definition?

Question 168. If the Agencies were to provide a characteristics-based exclusion, would any existing exclusions from the definition of "covered fund" be unnecessary? If so, which ones and why?

Question 169. If the Agencies were to provide a characteristics-based exclusion, to what extent and how should the Agencies consider section 13's limitations both on proprietary trading and on covered fund activities? For example, section 13 limits a banking entity's ability to engage in proprietary trading, which section 13 defines as engaging as a principal for the trading account, and defines the term "trading account" generally as any account used for acquiring or taking positions in the securities and the instruments specified in the proprietary trading definition 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).[174] This suggests that a fund engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements, should be included in the covered fund definition in order to prevent a banking entity from evading the limitations in section 13 through investments in funds. The statute also, however, contemplates that the covered fund definition would include funds that make longer-term investments and specifically references private equity funds. For

[174] *See* 12 U.S.C. 1851(h)(4) (defining "proprietary trading"); 12 U.S.C. 1851(h)(6) (defining "trading account").

example, the statute provides for an extended conformance period for "illiquid funds," which section 13 defines, in part, as hedge funds or private equity funds that, as of May 1, 2010, were principally invested in, or were invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments.[175] Trading strategies involving these and other types of illiquid assets generally do not involve selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements.

Question 170. Should the Agencies therefore provide an exclusion from the covered fund definition for a fund that (i) is not engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements; and (ii) does not invest, or principally invest, in illiquid assets, such as portfolio companies, real estate investments, and venture capital investments? Would this or a similar approach help to exclude from the covered fund definition issuers that do not engage in the investment activities contemplated by section 13? Would such an approach be sufficiently clear? Would it be clear when a fund is and is not engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements? Would this approach result in funds being excluded from the definition that commenters believe should be covered funds under the rule? The Agencies similarly request comment as to whether a reference to illiquid assets, with the examples drawn from section 13, would be sufficiently clear and, if not, how the Agencies could provide greater clarity.

Question 171. Rather than providing a characteristics-based exclusion, should the Agencies instead revise the base definition of "covered fund" using a characteristics-based

[175] 12 U.S.C. 1851(c)(3).

approach?[176] That is, should the Agencies provide that none of the types of funds currently included in the base definition—investment companies but for section 3(c)(1) or 3(c)(7) and certain commodity pools and foreign funds—will be covered funds in the first instance unless they have characteristics of a hedge fund or private equity fund?

vi. **Joint Ventures**

The Agencies, in tailoring the covered fund definition, noted that many joint ventures rely on section 3(c)(1) or 3(c)(7). Under the 2013 final rule, a joint venture is excluded from the covered fund definition if the joint venture (i) is between the banking entity or any of its affiliates and no more than 10 unaffiliated co-venturers; (ii) is in the business of engaging in activities that are permissible for the banking entity other than investing in securities for resale or other disposition; and (iii) is not, and does not hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities.[177] The Agencies observed in the preamble to the 2013 final rule that, with this exclusion, banking entities "will continue to be able to share the risk and cost of financing their banking activities through these types of entities which . . . may allow banking entities to more efficiently manage the risk of their operations."[178]

In 2015, the staffs of the Agencies provided a response to FAQs regarding the extent to which an excluded joint venture could invest in securities, consistent with the condition in the 2013 final rule that an excluded joint venture may not be an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other

[176] *See supra* Part III.C.1.a.i.

[177] *See* 2013 final rule § __ .10(c)(3).

[178] 79 FR at 5681.

disposition or otherwise trading in securities.[179] The Agencies observed in the preamble to the 2013 final rule that this condition "prevents a banking entity from relying on this exclusion to evade section 13 of the BHC Act by owning or sponsoring what is or will become a covered fund."[180] The staffs expressed the view in their response to a FAQ that this condition generally could not be met by, and the exclusion would therefore not be available to, an issuer that:

- "[R]aise[s] money from investors primarily for the purpose of investing in securities for the benefit of one or more investors and sharing the income, gain or losses on securities acquired by that entity," observing that "[t]he limitations in the joint venture exclusion are meant to ensure that the joint venture is not an investment vehicle and that the joint venture exclusion is not used as a means to evade the limitations in the BHC Act on investing in covered funds";
- "[R]aises money from a small number of investors primarily for the purpose of investing in securities, whether the securities are intended to be traded frequently, held for a longer duration, held to maturity, or held until the dissolution of the entity"; or
- "[R]aises funds from investors primarily for the purpose of sharing in the benefits, income, gains or losses from ownership of securities—as opposed to conducting a business or engaging in operations or other non-investment activities," reasoning that such an issuer "would be raising money from investors primarily for the purpose of 'investing in securities,' even if the vehicle may have

[179] *See supra* note. 21.

[180] 79 FR at 5681. The Agencies also observed that, "[c]onsistent with this restriction and to prevent evasion of section 13, a banking entity may not use a joint venture to engage in merchant banking activities because that involves acquiring or retaining shares, assets, or ownership interests for the purpose of ultimate resale or disposition of the investment." *Id.*

> other purposes," and that the exclusion "also is not met by an entity that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities merely because one of the purposes for establishing the vehicle may be to provide financing to an entity to obtain and hold securities."

The staffs also observed that, in addition to the conditions in the joint venture exclusion, as an initial matter, an entity seeking to rely on the exclusion must be a joint venture. The staffs observed that the basic elements of a joint venture are well recognized, including under state law, although the term is not defined in the 2013 final rule. The staffs also observed that although any determination of whether an arrangement is a joint venture will depend on the facts and circumstances, the staffs generally would not expect that a person that does not have some degree of control over the business of an entity would be considered to be participating in "a joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons," as specified in the 2013 final rule's joint venture exclusion.

The Agencies request comment on all aspects of the 2013 final rule's exclusion for joint ventures, including the extent to which the Agencies should modify the joint venture exclusion:

Question 172. Has the 2013 final rule's exclusion for joint ventures allowed banking entities to continue to be able to share the risk and cost of financing their banking activities through joint ventures, and therefore allowed banking entities to more efficiently manage the risk of their operations, as contemplated by the Agencies in adopting this exclusion? If not, what modifications should the Agencies make to the joint venture exclusion?

Question 173. Should the Agencies make any changes to the joint venture exclusion to clarify the condition that a joint venture may not be an entity or arrangement that raises money

from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities? Should the Agencies incorporate some or all of the views expressed by the staffs in their FAQ response? If so, which views and why? Should the Agencies, for example, modify the conditions to clarify that an excluded joint venture may not be, or hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities, whether the securities are intended to be traded frequently, held for a longer duration, held to maturity, or held until the dissolution of the entity? Conversely, do the views expressed by the staffs in their FAQ response, or similar conditions the Agencies might add to the joint venture exclusion, affect the utility of the joint venture exclusion? If so, how could the Agencies increase or preserve the utility of the joint venture exclusion as a means of structuring business arrangements without allowing an excluded joint venture to be used by a banking entity to invest in or sponsor what is in effect a covered fund that merely has no more than ten unaffiliated investors?

Question 174. Are there other conditions the Agencies should include, or modifications to the exclusion's current conditions that the Agencies should make, to clarify that the joint venture exclusion is designed to allow banking entities to structure business ventures, as opposed to an entity that may be labelled a joint venture but that is in reality a hedge fund or private equity fund established for investment purposes?

Question 175. The 2013 final rule does not define the term "joint venture." Should the Agencies define that term? If so, how should the Agencies define the term? Should the Agencies, for example, modify the 2013 final rule to reflect the view expressed by the staffs that a person that does not have some degree of control over the business of an entity would generally not be considered to be participating in "a joint venture between a banking entity or any of its

affiliates and one or more unaffiliated persons"? Would this modification serve to differentiate a participant in a joint venture from an investor in what would otherwise be a covered fund? Has state law been useful in determining whether a structure is a joint venture for purposes of the 2013 final rule? Are there other changes to the joint venture exclusion the Agencies should make on this point?

vii. **Securitizations**

The 2013 final rule contains several provisions designed to address securitizations and to implement the rule of construction in section 13(g)(2) of the BHC Act, which provides that nothing in section 13 shall be construed to limit or restrict the ability of a banking entity to sell or securitize loans in a manner that is otherwise permitted by law. These provisions include the 2013 final rule's exclusions from the covered fund definition for loan securitizations, qualifying asset-backed commercial paper conduits, and qualifying covered bonds. The Agencies request comment on all aspects of the 2013 final rule's application to securitizations, including:

Question 176. Are there any concerns about how the 2013 final rule's exclusions from the covered fund definition for loan securitizations, qualifying asset-backed commercial paper conduits, and qualifying covered bonds work in practice? If commenters believe the Agencies can make these provisions more effective, what modifications should the Agencies make and why?

Question 177. The 2013 final rule's loan securitization exclusion excludes an issuing entity for asset-backed securities that, among other things, has assets or holdings consisting solely of certain types of permissible assets enumerated in the 2013 final rule. These permissible assets generally are loans, certain servicing assets, and special units of beneficial interest and collateral certificates. Are there particular issues with complying with the terms of this exclusion for vehicles that are holding loans? Are there any modifications the Agencies should make and

if so, why and what are they? How would such modifications be consistent with the statutory provisions? For example, debt securities generally are not permissible assets for an excluded loan securitization.[181] What effect does this limitation have on loan securitization vehicles? Should the Agencies consider permitting a loan securitization vehicle to hold 5 percent or 10 percent of assets that are considered debt securities rather than "loans," as defined in the 2013 final rule? Are there other types of similar assets that are not "loans," as defined in the 2013 final rule, but that have similar financial characteristics that an excluded loan securitization vehicle should be permitted to own as 5 percent or 10 percent of the vehicle's assets? Conversely, would this additional flexibility be necessary or appropriate now that banking entities have restructured loan securitizations as necessary to comply with the 2013 final rule and structured loan securitizations formed after the 2013 final rule was adopted in order to comply with the 2013 final rule? After banking entities have undertaken these efforts, would allowing an excluded loan securitization to hold additional types of assets allow a banking entity indirectly to engage in investment activities that may implicate section 13 rather than as an alternative way for a banking entity either to securitize or own loans through a securitization, as contemplated by the rule of construction in section 13(g)(2) of the BHC Act?

Question 178. Should the Agencies modify the loan securitization exclusion to reflect the views expressed by the Agencies' staffs in response to a FAQ[182] that the servicing assets described in paragraph 10(c)(8)(i)(B) of the 2013 final rule may be any type of asset, provided that any servicing asset that is a security must be a permitted security under paragraph

[181] The 2013 final rule does, however, permit an excluded loan securitization to hold cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of the final rule, and securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities. *See* 2013 final rule § __.10(c)(8)(iii).

[182] *See supra* note 22.

10(c)(8)(iii) of the 2013 final rule? Should the Agencies, for example, modify paragraph 10(c)(8)(i)(B) of the 2013 final rule to add the underlined text: "Rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset that is a security meets the requirements of paragraph (c)(8)(iii) of this section." Should the 2013 final rule be amended to include this language? Are there other clarifying modifications that would better address the expressed concern?

Question 179. Are there modifications the Agencies should make to the 2013 final rule's definition of the term "ownership interest" in the context of securitizations? If so, what modifications should the Agencies make and how would they be consistent with the ownership interest restrictions? Banking entities have raised questions regarding the scope of the provision of the 2013 final rule that provides that an ownership interest includes an interest that has, among other characteristics, "the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event)" in the context of creditor rights. Should the Agencies modify this parenthetical to provide greater clarity to banking entities regarding this parenthetical? For example, should the Agencies modify the parenthetical to provide that the "rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event" include the right to participate in the removal of an investment manager for cause, or to nominate or vote on a nominated replacement manager upon an investment manager's resignation or removal? Would the ability to participate in the removal or replacement of an investment manager under these

limited circumstances more closely resemble a creditor's rights upon default to protect its interest, as opposed to the right to vote on matters affecting the management of an issuer that may be more typically associated with equity or partnership interests? Why or why not? What actions do holders of interests in loan securitizations today take with respect to investment managers and under what circumstances? Are such rights limited to certain classes of holders?

Question 180. The Agencies understand that in many securitization transactions, there are multiple tranches of interests that are sold. The Agencies also understand that some of these interests may have characteristics that are the same as debt securities with fixed maturities and fixed rates of interest, and with no other residual interest or payment. In the context of the definition of ownership interest for securitization vehicles, should the Agencies consider whether securitization interests that have only these types of characteristics be considered "other similar interests" for purposes of the ownership interest definition? If so, why or why not? If so, why should a distribution of profits from a passive investment such as a securitization be treated differently than a distribution of profits from any other type of passive investment? Please explain why securitization vehicles should be treated differently than other covered funds, some of which also could have tranched investment interests.

viii. **Selected Other Issuers**

In this section the Agencies request comment on the 2013 final rule's application to certain types of issuers for which banking entities and others have expressed concern to one or more of the Agencies:

Question 181. The 2013 final rule excludes from the covered fund definition an issuer that is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958, or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license

has not been revoked. A small business investment company that relinquishes its license as the company liquidates its holdings, however, will no longer be a "small business investment company," as defined in section 103(3) of the Small Business Investment Act of 1958, and will therefore no longer be excluded from the covered fund definition. Should the Agencies modify the exclusion to provide that the exclusion will remain available under these circumstances when a small business investment company relinquishes or voluntarily surrenders its license? If so, how should the Agencies specify the circumstances under which the company may operate after relinquishing or voluntarily surrendering its license while still relying on the exclusion? Does the absence of a license from the Small Business Administration under these circumstances affect whether the company is engaged in the investment activities contemplated by section 13? Why or why not? Are there other examples of an entity that is excluded from the covered fund definition and that could no longer satisfy the relevant exclusion as the entity is liquidated? Which kinds of entities, what causes them to no longer satisfy the exclusion, and what modifications to the 2013 final rule do commenters believe would be appropriate to address them? For example, have banking entities encountered any difficulties with respect to RICs that use liquidating trusts?

Question 182. The 2013 final rule does not provide a specific exclusion from the definition of "covered fund" for an issuer that is a municipal securities tender option bond vehicle.[183] The 2013 final rule "does not prevent a banking entity from owning or otherwise

[183] In the preamble to the 2013 final rule, the Agencies noted commenters' description of a "typical tender option bond transaction" as consisting of "the deposit of a single issue of highly-rated, long-term municipal bonds in a trust and the issuance by the trust of two classes of securities: a floating rate, puttable security (the "floaters"), and an inverse floating rate security (the "residual") with no tranching involved. According to commenters, the holders of the floaters have the right, generally on a daily or weekly basis, to put the floaters for purchase at par. The put right is supported by a liquidity facility delivered by a highly-rated provider (in

participating in a tender option bond vehicle; it requires that these activities be conducted in the same manner as with other covered funds."[184] To the extent that a tender option bond vehicle is a covered fund, then, § __.14 would apply. If a banking entity organizes and offers or sponsors a tender option bond vehicle, for example, § __.14 of the 2013 final rule prohibits the banking entity from engaging in any "covered transaction" with the vehicle. Such a "covered transaction" could include the sponsoring banking entity providing a liquidity facility to support the put right that is a key feature of the "floater" security issued by a tender option bond vehicle. The Agencies understand that after adoption of the 2013 final rule, banking entities restructured tender option bond vehicles, or structured new tender option bond vehicles formed after adoption, in order to comply with the 2013 final rule. What role do banking entities play in creating the tender option bond trust and how have the restrictions on "covered transactions" affected the continuing use of this financing structure? Why should tender option bond vehicles sponsored by banking entities be viewed differently than other types of covered funds sponsored by banking entities? As discussed above, the Agencies are requesting comment about whether to incorporate into § __.14's limitations on covered transactions the exemptions provided in section 23A of the FR Act and the Board's Regulation W. Would incorporating some or all of these exemptions address any challenges banking entities that sponsor tender option bond trusts have

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many cases, the banking entity sponsoring the trust) and allows the floaters to be treated as a short-term security. The floaters are in large part purchased and held by money market mutual funds. The residual is held by a longer-term investor (in many cases the banking entity sponsoring the trust, or an insurance company, mutual fund, or hedge fund). According to commenters, the residual investors take all of the market and structural risk related to the tender option bonds structure, with the investors in floaters taking only limited, well-defined insolvency and default risks associated with the underlying municipal bonds generally equivalent to the risks associated with investing in the municipal bonds directly. According to commenters, the structure of tender option bond transactions is governed by certain provisions of the Internal Revenue Code in order to preserve the tax-exempt treatment of the underlying municipal securities." *See* 79 FR at 5702.

[184] *See* 79 FR at 5703.

faced with respect to subsequent and ongoing covered transactions with such tender option bond vehicles?

2. Section __.11: Activities Permitted in Connection With Organizing and Offering a Covered Fund

a. Underwriting and Market Making for a Covered Fund

Section 13(d)(1)(B) of the BHC Act permits a banking entity to purchase and sell securities and other instruments described in 13(h)(4) in connection with certain underwriting or market making-related activities.[185] The 2013 final rule addressed how this exemption applied in the context of underwriting or market making of ownership interests in covered funds. In particular, § __.11(c) of the 2013 final rule provides that the prohibition in § __.10(a) on ownership or sponsorship of a covered fund does not apply to a banking entity's underwriting and market making-related activities involving a covered fund so long as:

The banking entity conducts the activities in accordance with the requirements of the underwriting exemption in § __.4(a) of the 2013 final rule or market-making exemption in § __.4(b) of the 2013 final rule, respectively;

The banking entity includes the aggregate value of all ownership interests of the covered fund acquired or retained by the banking entity and its affiliates for purposes of the limitation on aggregate investments in covered funds (the "aggregate-fund limit")[186] and capital deduction requirement;[187] and

The banking entity includes any ownership interests that it acquires or retains for purposes of the limitation on investments in a single covered fund (the "per-fund limit") if the

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[185] 12 U.S.C. 1851(d)(1)(B).

[186] *See* 2013 final rule § __.12(a)(iii).

[187] *See* 2013 final rule § __.12(d).

banking entity (or an affiliate): (i) acts as a sponsor, investment adviser, or commodity trading advisor 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 final 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 final 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.[188]

The Agencies continue to believe that providing a separate provision relating to permitted underwriting and market making-related activities for ownership interests in covered funds is supported by section 13(d)(1)(B) of the BHC Act. The exemption for underwriting and market making-related activities under section 13(d)(1)(B), by its terms, is a statutorily permitted activity and exemption from the prohibitions in section 13(a), whether on proprietary trading or on covered fund activities. Applying the statutory exemption in this manner accommodates the capital raising activities of covered funds and other issuers in accordance with the underwriting and market making provisions under the statute.

The proposed amendments to § __.11(c) are intended to better achieve these objectives, consistent with the requirements of the statute and based on the experience of the Agencies following implementation of the 2013 final rule. Specifically, for a covered fund that the banking entity does not organize or offer pursuant to § __.11(a) or (b) of the 2013 final rule, the

[188] *See* 2013 final rule § __.11(c).

proposal would remove the requirement that the banking entity include for purposes of the aggregate fund limit and capital deduction the value of any ownership interests of the covered fund acquired or retained in accordance with the underwriting or market-making exemption. Under the proposed amendments, these limits, as well as the per fund limit, would only apply to a covered fund that the banking entity organizes or offers and in which the banking entity retains an ownership interest pursuant to § __.11(a) or (b) of the 2013 final rule. The Agencies seek with 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. The Agencies expect this change would reduce compliance costs for banking entities that engage in these activities without exposing banking entities to additional risks beyond those inherent in underwriting and market making-related activities involving otherwise similar financial instruments as permitted by the statute. This is because banking entities that engage in underwriting or market making-related activities with respect to covered funds would remain subject to the requirements of those exemptions in subpart B, as modified by the proposal, including requirements relating to risk management and limitations based on the reasonably expected near term demand of clients, customers, or counterparties.

The proposal would retain the requirements of the 2013 final rule associated with the per-fund limit, aggregate fund limit, and capital deduction where the banking entity engages in activity in reliance on § __.11(a) or (b) with respect to a covered fund, consistent with the limitations of section 13(d)(1)(G)(iii) of the BHC Act that restrict a banking entity that relies on this exemption from acquiring or retaining an ownership interest in a covered fund beyond a de minimis investment amount.

In addition, the proposal would maintain the requirement that the underwriting or market-making-related activities be conducted in accordance with the requirements of § __.4(a) or § __4(b) of the 2013 final rule (as modified by the proposal), respectively. These requirements are designed specifically to address a banking entity's underwriting and market making-related activities and to permit holding exposures consistent with the reasonably expected near term demand of clients, customers and counterparties.

Question 183. What effects do commenters believe the proposed changes to the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in covered funds would have on the capital raising activities of covered funds and other issuers? What other changes should the Agencies consider, if any, 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? For example, because the exemption for underwriting and market making-related activities under section 13(d)(1)(B), by its terms, is a statutorily permitted activity and an exemption from the prohibitions in section 13(a), is it necessary to continue to retain the per-fund limit, aggregate fund limit, and capital deduction where the banking entity engages in activity in reliance on § __.11(a) or (b)? Should these limitations apply only with respect to covered fund interests acquired or retained by the banking entity in reliance on section 13(d)(1)(G)(iii) of the BHC Act, and not to interests held in reliance on the separate exemption provided for underwriting and market making activities, where the banking entity seeks to rely on separate exemptions for permitted activities related to the same covered fund? That is, should we remove the requirement that the banking entity include for purposes of the per fund limit, aggregate fund limit, and capital deduction the value of any

ownership interests of the covered fund acquired or retained in accordance with the underwriting or market-making exemption, regardless of whether the banking entity engages in activity in reliance on § __.11(a) or (b) with respect to the fund? Why or why not? Conversely, should the Agencies retain the requirement that all covered fund ownership interests acquired or retained in connection with underwriting or market-making-related activities be included for purposes of the aggregate fund limit and capital deduction as a means to effectuate the limitations on permitted activities in section (d)(2)(A) of the BHC Act?

Question 184. Please describe whether the restrictions on underwriting or market making of ownership interests in covered funds are appropriate. Why or why not?

Question 185. Please describe any potential restrictions that commenters believe should be included or indicate any restrictions that should be removed, along with the commenter's rationale for such changes, and how such changes would be consistent with the statute.

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

a. Permitted Risk-Mitigating Hedging Activities

Section 13(d)(1)(C) of the BHC Act provides an exemption for certain risk-mitigating hedging activities.[189] In the context of covered fund activities, the 2013 final rule implemented this authority narrowly, permitting only limited risk-mitigating hedging activities involving ownership interests in covered funds for hedging employee compensation arrangements. In particular, § __.13(a) of the 2013 final rule permits a banking entity to acquire or retain an ownership interest in a covered fund provided that the ownership interest is designed to demonstrably reduce or otherwise significantly mitigate the specific, identifiable risks to the

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

banking entity in connection with a compensation arrangement with an employee who directly provides investment advisory or other services to the covered fund.

In the 2011 proposal, the Agencies considered permitting a banking entity to acquire or retain an ownership interest in a covered fund as a hedge in a second context, in addition to hedging employee compensation arrangements. Specifically, the 2011 proposal included a provision that would have allowed a banking entity to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.[190] After receiving comments on the 2011 proposal, the Agencies determined not to include this second provision in the 2013 final rule. At the time, the Agencies determined based on information available and comments received, that transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, constituted a high-risk strategy that could threaten the safety and soundness of the banking entity. The Agencies were concerned that these transactions could expose the banking entity to the risk that the customer will fail to perform, thereby effectively exposing the banking entity to the risks of the covered fund, and that a customer's failure to perform may be concurrent with a decline in value of the covered fund, which could expose the banking entity to additional losses. The Agencies therefore concluded that these transactions could pose a significant potential to expose banking entities to the same or similar economic risks that section 13 of the BHC Act sought to eliminate.[191]

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[190] *See* 2011 proposal.

[191] *See* 79 FR at 5737.

Since the Agencies' adoption of the 2013 final rule, some market participants have argued that the 2013 final rule should be modified to permit a banking entity to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund. These market participants have urged that allowing banking entities to facilitate customer activity would be consistent with the intent of the statute. In the view of these market participants, permitting such activity would not be inconsistent with safety and soundness because it would be conducted consistent with the requirements of the 2013 final rule, as modified by the proposal, including the requirements with respect to risk-mitigating hedging transactions. For example, such exposures would be subject to required risk limits and policies and procedures and must be appropriately monitored and risk managed. Although a banking entity could be exposed to the risk of the covered fund if the customer fails to perform, this counterparty default risk would be present whenever a banking entity facilitates the exposure by the customer to the profits and losses of a financial instrument and seeks to hedge its own exposure by investing in the financial instrument.

Accordingly, the Agencies are including this provision in the proposal and requesting comment below as to whether the 2013 final rule should be modified to permit this additional category of risk-mitigating hedging transactions.

As in the 2011 proposal, this proposal would allow a banking entity to acquire a covered fund interest as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund. The hedging of employee compensation arrangements involving covered fund interests would remain unchanged from the 2013 final rule. Moreover, a banking entity that seeks to use

a covered fund interest to hedge on behalf of a customer would need to comply with all of the requirements of § __.13(a), which generally track the requirements of § __.5, as modified by this proposal.[192] The Agencies believe that to effectively implement the statute, banking entities should have a broader ability to acquire or retain a covered fund interest as a permissible hedging activity.

In addition to those questions raised in connection with the proposed implementation of the risk-mitigating hedging exemption under § __.5 of the proposal, the Agencies request comment on the proposed implementation of that same exemption with respect to covered fund activities. In particular, the Agencies request comment on the following questions:

Question 186. Should a banking entity be permitted to acquire or retain an ownership interest in a covered fund as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund? If so, what kinds of transactions would banking entities enter into to facilitate the exposure by the customer to the profits and losses of the covered fund, what types of covered funds would be used to hedge, how would they be used to hedge, and what kinds of customers would be involved? Should the Agencies place additional limitations on these arrangements, such as a requirement for a banking entity to take prompt action to hedge or eliminate its covered fund exposure if the customer fails to perform?

[192] The proposal would also amend § __.13(a) to align with the proposed modifications to § __5. In particular, the proposal would require 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 also remove the requirement that the hedging transaction "demonstrably reduces or otherwise significantly mitigates" the relevant risks, consistent with the proposed modifications to § __.5. *See supra* Part III.B.3 of this Supplementary Information section.

Question 187. At the time the Agencies adopted the 2013 final rule, they determined that transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, constituted a high-risk strategy that could threaten the safety and soundness of the banking entity. Do these arrangements constitute a high-risk strategy, threaten the safety and soundness of a banking entity, and pose significant potential to expose banking entities to the same or similar economic risks that section 13 of the BHC Act sought to eliminate? Why or why not? Commenters are encouraged to provide specific information that would help the Agencies' analysis of this question.

Question 188. Are there other circumstances on which a banking entity should be permitted to acquire or retain an ownership interest in a covered fund? If so, please explain. For example, should the Agencies amend the 2013 final rule to provide that, in addition to the proposed amendment, banking entities be permitted to acquire or retain ownership interests in covered funds where the acquisition or retention meets the requirements of § __.5 of the 2013 final rule, as modified by the proposal?

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

Section 13(d)(1)(I) of the BHC Act[193] 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

[193] 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).

investments occur solely outside the United States and certain other conditions are met (the foreign fund exemption).[194] The purpose of this statutory exemption appears to be to limit the extraterritorial application of the statutory restrictions on covered fund activities and investments, while preserving national treatment and competitive equity among U.S. and foreign banking entities within the United States.[195] The statute does not explicitly define what is meant by "solely outside of the United States."

i. **Activities or investments solely outside of the United States**

The 2013 final rule establishes several conditions on the availability of the foreign fund exemption. Specifically, the 2013 final rule provides 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 established under the laws of the United States or of any State;

[194] This section's discussion of the concept "solely outside of the United States" is provided solely for purposes of the proposal's implementation of section 13(d)(1)(I) 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.

[195] *See* 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley). ("Subparagraphs (H) and (I) recognize rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law. However, these subparagraphs are not intended to permit a U.S. banking entity to avoid the restrictions on proprietary trading simply by setting up an offshore subsidiary or reincorporating offshore, and regulators should enforce them accordingly. In addition, the subparagraphs seek to maintain a level playing field by prohibiting a foreign bank from improperly offering its hedge fund and private equity fund services to U.S. persons when such offering could not be made in the United States.").

- 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").[196]

Much like the similar requirement under the exemption for permitted trading activities of a foreign banking entity, experience since adoption of the 2013 final rule has indicated that the financing prong has been difficult to comply with in practice. As a result, the proposal would remove the financing prong of the foreign fund exemption for the same reasons as described above for the trading outside of the United States exemption. This modification would streamline the requirements of this exemption with the intention of improving implementation of the statutory exemption. Although a U.S. branch or affiliate that extends financing for a covered fund investment solely outside of the United States could bear some risks—for example, if the U.S. branch of an affiliate provides a loan secured by a covered fund interest that then declines in

[196] *See* final rule § __.13(b)(4).

value—the conditions to the foreign fund exemption, as modified by the proposal, are designed to require that the principal risks of covered fund investments and sponsorship by foreign banking entities permitted under the foreign fund exemption occur and remain solely outside of the United States. For example, the foreign fund exemption would continue to provide that the investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, may not be accounted for as principal directly or indirectly on a consolidated basis by any U.S. branch or affiliate. One of the principal purposes of section 13 of the BHC Act appears to be to limit the risks that covered fund investments and activities may pose to the safety and soundness of U.S. banking entities and the U.S. financial system. A purpose of the foreign fund exemption appears to be to limit the extraterritorial application of section 13 as it applies to foreign banking entities subject to section 13. The modifications to these requirements under the proposal are intended to ensure that any foreign banking entity engaging in activity under the foreign fund exemption does so in a manner that ensures the risk and sponsorship of the activity or investment occurs and resides solely outside of the United States.

ii. **Offered for sale or sold to a resident of the United States**

One of the restrictions of the exemption for covered fund activities conducted by foreign banking entities outside the United States is the restriction that no ownership interest in the covered fund may be offered for sale or sold to a resident of the United States.[197] To implement this restriction, § __.13(b) of the 2013 final rule requires, as one condition of the foreign fund exemption, that "no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States" (the "marketing restriction"). Section __.13(b)(3)

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

of the 2013 final rule further specifies that an ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of the marketing restriction if it is sold or has been sold pursuant to an offering that does not target residents of the United States.[198]

After issuance of the 2013 final rule, foreign banking entities requested clarification from the Agencies regarding whether the marketing restriction applied only to the activities of a foreign banking entity that is seeking to rely on the foreign fund exemption or whether it applied more generally to the activities of any person offering for sale or selling ownership interests in the covered fund. Specifically, sponsors of covered funds and foreign banking entities asked how this condition would apply to a foreign banking entity that has made, or intends to make, an investment in a covered fund where the foreign banking entity (including its affiliates) does not sponsor, or serve, directly or indirectly, as the investment manager, investment adviser, commodity pool operator, or commodity trading advisor to the covered fund (a third-party covered fund).

After issuance of the 2013 final rule, the staffs of the Agencies issued guidance to address these issues, and the proposal would amend the 2013 final rule to clearly incorporate this guidance.[199] The proposal therefore provides that an ownership interest in a covered fund is not offered for sale or sold to a resident of the United States for purposes of the marketing restriction only if it is not sold and has not been sold pursuant to an offering that targets residents of the United States 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 the marketing

[198] 2013 final rule § __.13(b)(3).

[199] https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#13.

restriction to participate in any offer or sale by the covered fund of ownership interests in the covered fund.[200]

The purpose of this provision is to make clear that the marketing restriction applies to the activity of the foreign banking entity that is seeking to rely on the exemption (including its affiliates). 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, thereby requiring that the foreign banking entity seeking to rely on this exemption does not engage in an offering of ownership interests that targets residents of the United States. This view is consistent with limiting the extraterritorial application of section 13 to foreign banking entities while seeking to ensure that the risks of covered fund investments by foreign banking entities occur and remain solely outside of the United States. 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), this exemption may not be available in certain circumstances where the risks and activities of a foreign banking entity with respect to its investment in the covered fund are solely outside the United States.[201] In describing the marketing restriction in the preamble to the 2013 final rule, the Agencies stated that the marketing restriction serves to limit the foreign fund exemption so that it "does not advantage foreign banking entities relative to U.S. banking entities with respect to providing

[200] *See* proposal § __.13(b)(3).

[201] The Agencies note that foreign funds that sell securities to residents of the United States in an offering that targets residents of the United States will be covered funds under § __.10(b)(i) of the 2013 final rule if such funds are unable to rely on an exclusion or exemption under the Investment Company Act other than section 3(c)(1) or 3(c)(7) of that Act. If the marketing restriction were to apply more generally to the activities of any person (including the covered fund itself), the applicability of the foreign fund exemption would be significantly limited because a third-party foreign fund's offering that targets residents of the United States would make the foreign fund exemption unavailable for all foreign banking entity investors in the fund.

their covered fund services in the United States by prohibiting the offer or sale of ownership interests in *related* covered funds to residents of the United States."[202]

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

The Agencies request comment on the proposal's approach to implementing the foreign fund exemption. In particular, the Agencies request comment on the following questions:

Question 189. Is the proposal's implementation of the foreign fund exemption effective? If not, what alternative would be more effective and/or clearer?

Question 190. Are the proposal's provisions effective and sufficiently clear regarding when a transaction or activity will be considered to have occurred solely outside the United States? If not, what alternative would be more effective and/or clearer?

Question 191. Should the financing prong of the foreign fund exemption be retained? Why or why not? Should additional requirements be added to the foreign fund exemption? If

[202] *See*, 79 FR at 5742 (emphasis added).

so, what requirements and why? Should additional requirements be modified or removed? If so, what requirements and why and how? How would such changes be consistent with the statute?

Question 192. Is the proposed exemption consistent with limiting the extraterritorial reach of the rule with respect to FBOs? Does the proposed exemption create competitive advantages for foreign banking entities with respect to U.S. banking entities? Why or why not?

Question 193. Is the Agencies' proposal regarding the 2013 final rule's marketing restriction, which reflects the staff interpretations incorporated within previous FAQs, sufficiently clear? Should the marketing restriction apply more broadly to third-party funds that the foreign banking entity does not advise or sponsor? Why or why not?

4. Section __.14: Limitations on Relationships with a Covered Fund

Section 13(f) of the BHC Act generally prohibits a banking entity that, directly or indirectly, serves as investment manager, investment adviser, or sponsor to a covered fund (or that organizes and offers a covered fund pursuant to section 13(d)(1)(G) of the BHC Act) from entering into a transaction with such covered fund that would be a covered transaction as defined in section 23A of the FR Act.[203] In the 2013 final rule, the Agencies noted that "[s]ection 13(f) of the BHC Act does not incorporate or reference the exemptions contained in section 23A of the FR Act or the Board's Regulation W."[204] However, the Agencies also noted that notwithstanding the prohibition in section 13(f)(1) of the BHC Act, "other specific portions of the statute permit a banking entity to engage in certain transactions or relationships" with a

[203] 12 U.S.C. § 371c. The Agencies note that this does not alter the applicability of section 23A of the FR Act and the Board's Regulation W to covered transactions between insured depository institutions and their affiliates.

[204] 79 FR at 5746.

related covered fund.[205] The Agencies addressed the apparent conflict between section 13(f)(1) and particular provisions in section 13(d)(1) of the BHC Act in the 2013 final rule by interpreting the statutory language to permit a banking entity "to acquire or retain an ownership interest in a covered fund in accordance with the requirements of section 13."[206] In doing so, the Agencies noted that a contrary interpretation would make the "specific transactions that permit covered transactions between a banking entity and a covered fund mere surplusage."[207] In light of the apparent conflict and ambiguity between particular provisions in sections 13(d)(1) and 13(f)(1) of the BHC Act, the Agencies solicit comment below on the approach adopted in the 2013 final rule and potential alternative approaches to interpreting these provisions and reconciling any apparent conflicts or redundancies between these provisions.

Section 13(f) also provides an exemption for prime brokerage transactions between a banking entity and a covered fund in which a covered fund managed, sponsored, or advised by that banking entity has taken an ownership interest. In addition, section 13(f) subjects any transaction permitted under section 13(f) of the BHC Act (including a permitted prime brokerage transaction) between a banking entity and covered fund to section 23B of the FR Act.[208] In general, section 23B of the FR Act requires that the transaction be on market terms or on terms at least as favorable to the banking entity as a comparable transaction by the banking entity with an unaffiliated third party. Section __.14 of the 2013 final rule implemented these provisions.[209]

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[205] *Id*.

[206] *Id*.

[207] *Id*.

[208] 12 U.S.C. 371c-1.

[209] *See* 2013 final rule § __.14.

a. Prime brokerage transactions

Section 13(f) of the BHC Act provides an exemption from the prohibition on covered transactions with a covered fund for any prime brokerage transaction with a covered fund in which a covered fund managed, sponsored, or advised by a banking entity has taken an ownership interest (a "second-tier fund"). The statute by its terms permits a banking entity with a relationship to a covered 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 covered funds more generally. 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. Under the statute, the exemption for prime brokerage transactions is available only so long as certain enumerated conditions are satisfied.[210] The conditions are that (i) the banking entity is in compliance with each of the limitations set forth in § __.11 of the 2013 final rule with respect to a covered fund organized and offered by the banking entity or any of its affiliates; (ii) the CEO (or equivalent officer) of the banking entity certifies in writing annually that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and (iii) the Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity. The proposal would retain each of these provisions, including that the required certification be made to the appropriate Agency for the banking entity.

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

The staffs of the Agencies previously issued guidance explaining when a banking entity was required to provide this certification during the conformance period.[211] To reflect this guidance, the Agencies are proposing a change to the rule that provides the timing for when a banking entity must submit such certification. In particular, the proposal provides a banking entity must provide the CEO certification annually no later than March 31 of the relevant year. As under the 2013 final 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. This change is 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.

b. FCM Clearing Services

On March 29, 2017, the CFTC's Division of Swap Dealer and Intermediary Oversight ("DSIO") issued a letter to a futures commission merchant ("FCM") stating that the DSIO would not recommend that an enforcement action against the FCM be initiated in connection with § __.14(a) of the 2013 final rule. The letter provides relief for futures, options, and swaps clearing services provided by a registered FCM to covered funds for which affiliates of the FCM are engaged in the services identified in § __.14(a) including, for example, investment management services.[212]

The CFTC believes the relief provided to the FCM is warranted and would extend the relief from the requirements of § __.14(a) of the 2013 final rule to all FCMs performing futures, options, and swaps clearing services. Providing such clearing services to customers of affiliates

[211] https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#18.

[212] CFTC Staff Letter 17-18 (Mar. 29, 2017).

does not appear to be the type of relationship that was intended to be limited under section 13(f) of the BHCA. The provision of futures, options, and swaps clearing services by an FCM is a facilitation service that the CFTC believes would not give rise to a relationship that might evade the prohibition against acquiring or retaining an interest in or sponsoring a covered fund. An FCM earns clearing fees and is not in a position to profit from any gain or loss that the customer may have on its cleared futures, options, or swaps positions. The other Agencies do not object to the relief provided to the FCMs as described above.

Question 194. Are clearing services provided by an FCM to its customers a relationship that would give rise to the policy concerns addressed by § __.14 of the 2013 final rule?

Question 195. Does the no-action relief provided by the CFTC staff together with the statement herein provide sufficient certainty for market participants regarding the application of § __.14(a) of the 2013 final rule to FCM clearing services?

Question 196. If the exemptions in section 23A of the FR Act and the Board's Regulation W are made available under a modification to § __.14 of the 2013 final rule, what would be the effect, if any, for FCM clearing services? Would incorporating those exemptions further support the relief provided by the CFTC? If so, how?

The Agencies request comment on all aspects of the proposal's approach to implementing the limitations on certain relationships with covered funds. In particular, the Agencies request comment on the following questions:

Question 197. Is the proposal's approach to implementing the limitations on certain transactions with a covered fund effective? If not, what alternative approach would be more effective and why?

Question 198. Should the Agencies adopt a different interpretation of section 13(f)(1) of the BHC Act than the interpretation adopted in the preamble to the 2013 final rule? For example, should the Agencies amend § __.14 of the 2013 final rule to incorporate some or all of the exemptions in section 23A of the FR Act and the Board's Regulation W? Why or why not? Why should these transactions be permitted? For example, what would be the effect on banking entities' ability to meet the needs and demands of their clients and how would incorporating some or all of the exemptions that exist in section 23A of the FR Act and the Board's Regulation W facilitate a banking entity's ability to meet client needs and demands? If permitted, should these additional transactions be subject to any limitations?

Question 199. Should the Agencies amend § __.14 of the 2013 final rule to incorporate the quantitative limits in section 23A of the Federal Reserve and the Board's Regulation W? Why or why not? Are there any other elements of section 23A and the Board's Regulation W that the Agencies should consider incorporating? Please explain.

Question 200. Are there other transactions between a banking entity and covered funds that should be prohibited or limited as part of this rulemaking?

Question 201. Is the definition of "prime brokerage transaction" under the proposal appropriate? If not, what definition would be appropriate? Are there any transactions that should be included in the definition of "prime brokerage transaction" that are not currently included?

Question 202. With respect to the CEO (or equivalent officer) certification required under section 13(f)(3)(A)(ii) and § __.14(a)(2)(ii)(B) of this proposal, what would be the most useful, efficient method of certification (e.g., a new stand-alone certification, a certification incorporated into an existing form or filing, Web site certification or certification filed directly

with the relevant Agency?) Is it sufficiently clear by when a certification must be provided by a banking entity? If not, how could the Agencies provide additional clarity?

D. Subpart D—Compliance Program Requirements; Violations

1. Section __.20: Program for compliance; reporting

Section __.20 of the 2013 final rule contains compliance program and metrics collection and reporting requirements. These requirements are tailored based on banking entity size and complexity of activity. The 2013 final 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.[213] However, public feedback has indicated that even determining whether a banking entity is eligible for the simplified compliance program can require significant analysis for small banking entities. In addition, certain traditional banking activities of small banks have fallen within the scope of the proprietary trading and covered fund prohibitions and exemptions, making them ineligible for the simplified program available to banking entities with no covered activities. Public feedback has indicated that the compliance program requirements are also significant for larger banking entities that must implement the rule's enhanced compliance program, metrics, and CEO attestation requirements. The Agencies propose to revise the compliance program requirements to allow greater flexibility and focus the requirements on the banking entities with the most significant and complex activities.

[213] The OCC, Board and FDIC statement on the 2013 final rule's applicability to community banks recognized that "[t]he vast majority of these community banks have little or no involvement in prohibited proprietary trading or investment activities in covered funds. Accordingly, community banks do not have any compliance obligations under the final rule if they do not engage in any covered activities other than trading in certain government, agency, State or municipal obligations." Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, The Volcker Rule: Community Bank Applicability (Dec. 10, 2013).

Specifically, the Agencies propose to apply the compliance program requirement to banking entities as follows:

- **Banking entities with significant trading assets and liabilities**. Banking entities with significant trading assets and liabilities would be subject to the six-pillar compliance program requirement (currently set forth in § __.20(b) of the 2013 final rule), the metrics reporting requirements (§ __.20(d) of the 2013 final rule), the covered fund documentation requirements (§ __.20(e) of the 2013 final rule), and the CEO attestation requirement (currently in Appendix B of the 2013 final rule).
- **Banking entities with moderate trading assets and liabilities**. Banking entities with moderate trading assets and liabilities would be required to establish the simplified compliance program (currently described in § __.20(f)(2) of the 2013 final rule), and comply with the CEO attestation requirement (currently in Appendix B of the 2013 final rule).
- **Banking entities with limited trading assets and liabilities**. Banking entities with limited trading assets and liabilities would be presumed to be in compliance with the proposal and would have no obligation to demonstrate compliance with subpart B and subpart C of the implementing regulations on an ongoing basis. These banking entities would not be required to demonstrate compliance with the rule unless and until the appropriate Agency, based upon a review of the banking entity's activities, determines that the banking entity must establish the simplified compliance program (currently described in §§ __.20(b) or __.20(f)(2) of the 2013 final rule).

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 final 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 final 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 final rule;

- A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and the 2013 final 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 final 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 final rule, these six elements must be part of the 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.

The Agencies are proposing to apply the six-pillar compliance program requirements only to banking entities with significant trading assets and liabilities. The Agencies preliminarily believe these banking entities are engaged in activities at a scale that warrants the costs of establishing the compliance program elements described in §§ __.20(b) and __.20(e) of the 2013 final 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.

As described further in the "Enhanced Minimum Standards for Compliance Programs" below, the Agencies are proposing to eliminate the current enhanced compliance program requirements found in Appendix B of the 2013 final rule. The Agencies believe that the six-pillar compliance program requirements (currently in § __.20(b) of the 2013 final rule) can be appropriately tailored to the size and activities of each banking entity that is subject to these requirements. The proposed approach would afford banking entities flexibility to integrate the § __.20 compliance program requirements into other compliance programs of the banking entity,

which may reduce complexity for banking entities currently subject to the enhanced compliance program requirements.

Question 203. Should the six-pillar compliance program requirements apply only to banking entities with significant trading assets and liabilities? Is the scope of the six-pillar compliance program appropriate? Why or why not? Are there particular aspects of this requirement that should be modified or eliminated? If so, which ones and why?

ii. **CEO Attestation Requirement**

The 2013 final rule includes a requirement, currently included in Appendix B, that a banking entity 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 final rule in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and the implementing regulations. The Agencies are proposing to eliminate the current Appendix B (as described further below) but to apply a modified CEO attestation requirement for banking entities other than those with limited trading assets and liabilities. While the Agencies believe the revisions to the compliance program requirements under the proposal generally 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 believe that applying the CEO attestation requirement for 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 are reasonably designed to achieve compliance with section 13 of the BHC Act and the implementing regulations as proposed. The Agencies propose limiting the CEO attestation requirement to banking entities with significant trading assets and liabilities or

moderate trading assets and liabilities because, if the Agencies' proposal is adopted, banking entities with limited trading assets and liabilities would be subject to a rebuttable presumption of compliance, as described below. The Agencies do not believe it is 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.

Question 204. What are the costs associated with preparing the required CEO attestation? How significant are those costs relative to the potential benefits of requiring a CEO attestation? What are some of the specific operational or other burdens or expenses associated with the CEO attestation requirement? Please explain the circumstances under which those potential burdens or expenses may arise.

Question 205. Are there existing business practices and procedures that render the CEO attestation requirement redundant and/or unnecessary? If so, please identify and describe those existing business practices. Alternatively, are there other regulatory requirements that fulfill the same purpose as the CEO attestation with respect to a compliance program? Please explain.

Question 206. Is the scope of the CEO attestation requirements appropriate? Should banking entities with limited trading assets and liabilities, but with a large amount of consolidated assets, for example consolidated assets in excess of $50 billion be required to provide a CEO attestation with respect to the banking entity's compliance program notwithstanding that such institution may be entitled to the rebuttable presumption of compliance under the proposal?

Question 207. How costly are the existing CEO attestation requirements for banking entities, broken down based on whether they are categorized as having significant, moderate, and

limited trading assets and liabilities under the proposal? How would those annual costs change if the modifications described in the proposal were adopted? Can the costs described above, both as the requirement is currently drafted and as proposed to be amended, be broken down based on the type of banking entity involved, such as for broker-dealers and registered investment advisers? Please be as specific as possible.

Question 208. Under the proposal, banking entities with limited trading assets and liabilities (for which the presumption of compliance has not been rebutted) would not be subject to the CEO attestation requirement? Do commenters agree with that approach? As an alternative, should a banking entity with limited trading assets and liabilities be subject to a similar requirement? For example, should these types of banking entities be required to conduct an annual review, to be performed by objective, qualified personnel, of its compliance with the rule and submit such annual review to its Board of Directors and the Agencies? Why or why not? What are the costs and benefits of such requirement?

iii. **Covered Fund Documentation Requirements**

Currently, § __.20(e) of the 2013 final rule requires banking entities with greater than $10 billion in total consolidated assets to maintain additional documentation related to covered funds as part of their compliance program. The Agencies are proposing to apply the covered fund documentation requirements only to banking entities with significant trading assets and liabilities. The Agencies do not believe that these additional documentation requirements are necessary for banking entities without significant trading assets and liabilities because the Agencies expect that their covered funds activities may generally be smaller in scale and less complex than banking entities with significant trading assets and liabilities. Accordingly, the Agencies believe these banking entities' activities are unlikely to justify the costs associated with

complying with these documentation requirements. Furthermore, the Agencies expect they would be able to examine and supervise these banking entities' compliance with the covered fund prohibition without requiring such additional documentation as part of the banking entities' compliance program.

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

The 2013 final rule provides 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 final rule (other than trading activities permitted under § __.6(a) of the 2013 final rule) may satisfy the compliance program requirements by including in its existing compliance policies and procedures 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.[214]

The Agencies propose to extend availability of this simplified compliance program to all banking entities with moderate trading assets and liabilities. The Agencies believe that streamlining the compliance program requirements for banking entities with moderate trading assets and liabilities is appropriate. 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 final rule and may be appropriately examined and supervised through an appropriately tailored simplified compliance program. Consistent with the compliance program requirements for banking entities with significant trading assets and liabilities, the Agencies note that banking entities with

[214] 12 CFR 44.20(f)(2).

moderate trading assets and liabilities would be able to incorporate their simplified compliance program as part of any existing compliance policies and procedures and tailor their compliance program to the size and nature of their activities.

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

The proposal would include a presumption of compliance for certain banking entities with limited trading assets and liabilities. Under the proposal, a banking entity that, together with its affiliates and subsidiaries on a worldwide basis, has trading assets and liabilities (excluding obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion, would be presumed to be in compliance with the proposal. Banking entities meeting these conditions would have no obligation to demonstrate compliance with subpart B and subpart C of the implementing regulations on an ongoing basis. The Agencies believe, based on experience implementing and supervising compliance with the 2013 final rule, that these banking entities are generally engaged in traditional banking activities. The Agencies do not believe it is necessary to require banking entities with limited trading assets and liabilities to demonstrate compliance with the prohibitions of section 13 of the BHC Act by establishing a compliance program, given the limited scale of their trading operations. Further, the Agencies believe that the limited trading assets and liabilities of the banking entities qualifying for the presumption of compliance are unlikely to warrant the costs of establishing a compliance program under § __.20.

A banking entity that meets the proposed criteria for the presumption of compliance would be subject to the statutory prohibitions of section 13 of the BHC Act and the implementing regulations on an ongoing basis. The Agencies would not expect a banking entity

that meets the proposed criteria for the presumption of compliance to demonstrate compliance with the proposal in conjunction with the Agencies' normal supervisory and examination processes. However, the appropriate Agency may exercise its authority to treat the banking entity as if it does not have limited trading assets and liabilities if, upon review of the banking entity's activities, the relevant Agency determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C. A banking entity would be expected to remediate any impermissible activity upon being notified of such determination by the Agency. A banking entity would be required to remediate the impermissible activity within a period of time deemed appropriate by the relevant Agency.

The Agencies believe this presumption of compliance for certain banking entities with limited trading assets and liabilities would allow flexibility for these banking entities to operate under their existing internal policies and procedures. The Agencies generally expect these banking entities, in the ordinary course of business, to develop and adhere to internal policies and procedures that promote prudent risk management practices.

Irrespective of whether a banking entity has engaged in activities in violation of subpart B or C of this proposal, the relevant Agency retains 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 determines that the size or complexity of the banking entities trading or investment activities, or the risk of evasion, does not warrant a presumption of compliance.

Question 209. Should the Agencies specify the notice and response procedures in connection with an Agency determination that the presumption pursuant to __.20(g)(2) is rebutted? Why or why not?

d. Enhanced Minimum Standards

i. **Enhanced Minimum Standards for Compliance Programs**

Section __. 20(c) of the 2013 final rule requires certain banking entities to establish, maintain and enforce an enhanced compliance program that includes the requirements and standards. Appendix B of the 2013 final rule specifies the enhanced minimum standards applicable to the compliance programs of large banking entities and banking entities engaged in significant trading activities. Section I.a of Appendix B provides that the enhanced compliance program must:

- Be reasonably designed to identify, document, monitor, and report the covered trading and covered fund activities and investments of the banking entity; identify, monitor and promptly address the risks of these covered activities and investments and potential areas of noncompliance; and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and the 2013 final rule;
- Establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity, and risks of the individual activities or investments consistent with the requirements of section 13 of the BHC Act and the 2013 final rule;
- 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;

- 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
- Facilitate supervision and examination by the Agencies of the banking entity's covered trading and covered fund activities and investments.

The Agencies continue to believe that banking entities with significant trading assets and liabilities should have detailed and comprehensive programs for ensuring compliance with the requirements of section 13 of the BHC Act. The Agencies recognize, however, that many banking entities have found implementing certain aspects of the enhanced compliance program requirements of Appendix B to be inefficient, duplicative of, and in some instances inconsistent with, their existing compliance regimes and risk management programs.

While recognizing the need to establish and maintain an appropriate compliance program, the Agencies also believe that banking entities should be provided discretion to tailor their compliance programs to the structure and activities of their organizations. The flexibility to build on compliance regimes that already exist at banking entities, including risk 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 section 13 of the BHC Act. After carefully considering the overall effects of the enhanced compliance program standards in the context of existing banking entity compliance frameworks, the Agencies are proposing certain modifications to limit the implementation, operational or other complexities associated with the compliance program requirements set forth in § __.20.

The Agencies believe that many of the compliance requirements of the current enhanced compliance program could be implemented effectively if incorporated into a risk management framework already developed and designed to fit a banking entity's organizational and reporting structure. The prescribed six-pillar compliance requirements in § __.20 are consistent with general standards of safety and soundness as well as diligent supervision, the implementation of which conforms with the traditional risk management processes of ensuring governance, controls, and records appropriately tailored to the risks and activities of each banking entity. Accordingly, the Agencies propose to eliminate the requirements of Appendix B (other than the CEO attestation) and permit banking entities with significant trading assets and liabilities to satisfy compliance program requirements by meeting the six elements currently specified in § __.20(b) of the 2013 final rule, commensurate with the size, scope, and complexity of their activities and business structure, and subject to a CEO attestation requirement.

A banking entity that does not have significant trading assets and liabilities under the proposal, but which is currently subject to Appendix B under the 2013 final rule, would be permitted to satisfy its compliance requirements in the proposal by including in its existing compliance policies and procedures appropriate references to the requirements of section 13 of the BHC Act as appropriate given the activities, size, scope, and complexity of the banking entity.

ii. **Proprietary Trading Activities**

Section II.a of Appendix B of the 2013 final rule generally requires a banking entity subject to the Appendix, in addition to the requirements of § __.20, to: (1) have written policies and procedures governing each trading desk; (2) include a comprehensive description of the risk management program for the trading activity of the banking entity; (3) implement and enforce limits and internal controls for each trading desk that are reasonably designed to ensure that

trading activity is conducted in conformance with section 13 of the BHC Act and subpart B and with the banking entity's policies and procedures; (4) establish, maintain and enforce policies and procedures regarding the use of risk-mitigating hedging instruments and strategies; (5) perform robust analysis and quantitative measurement of its trading activities that is reasonably designed to ensure that the trading activity of each trading desk is consistent with the banking entity's compliance program, monitor and assist in the identification of potential and actual prohibited proprietary trading activity, and prevent the occurrence of prohibited proprietary trading; (6) identify the activities of each trading desk that will be conducted in reliance on the exemptions contained in §§ __.4 through __.6; and (7) be reasonably designed and established to effectively monitor and identify for further analysis any proprietary trading activity that may indicate potential violations of section 13 of the BHC Act and subpart B and to prevent violations of section 13 of the BHC Act and subpart B.

These requirements of Appendix B in the 2013 final rule reflect the Agencies' expectation that banking organizations with significant trading activities adopt compliance regimes that, among other things, take into account the size and complexity of the banking entity's activities and structure of its business. However, the Agencies recognize that operationalizing the prescriptive requirements of Appendix B may limit the ability of banking entities to adapt their existing risk management frameworks for purposes of compliance with the 2013 final rule. Therefore, based on experience since the adoption of the 2013 final rule, the Agencies believe that a banking entity currently subject to Appendix B requirements under the 2013 final rule should be permitted to implement an appropriately robust compliance program by tailoring the requirements of § __.20 to the type, size, scope, and complexity of its activities and business structure. The Agencies are therefore proposing to eliminate the requirements of

section II.a of Appendix B in order to reduce the operational complexities associated with the compliance requirements of the 2013 final rule. As described above, the Agencies believe that the compliance program requirements in §§ __.20 can be appropriately scaled (pursuant to § __.20(a)) to the size, scope, and complexity of each banking entity and should afford banking entities flexibility to integrate their § __.20 compliance program into their other compliance programs.

The Agencies believe that, under the proposal, compliance programs that satisfy § __.20 and that are appropriately tailored to the size, scope, and complexity of the banking entity's activities, would be effective in meeting the objectives underlying the enhanced requirements set forth in Appendix B of the 2013 final rule with respect to proprietary trading activities. Furthermore, affording banking entities the flexibility to adapt their existing risk management frameworks to satisfy the requirements of § __.20 would reduce the complexity of compliance with section 13 of the BHC Act and the implementing regulations.

Question 210. The Agencies are requesting comment on whether the requirements of § __.20 of the proposal would be effective in ensuring that banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities comply with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the proposal. In addition to the CEO attestation requirement in proposed § ___.20(c), are there certain requirements included in Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading assets and liabilities, in order to ensure compliance with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the proposal? To what extent would the elimination of Appendix B reduce the complexity of compliance with section 13 of the BHC

Act? What other options should the Agencies consider in order to reduce complexity while still ensuring robust compliance with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the implementing regulations?

iii. **Covered Fund Activities and Investments**

The enhanced minimum standards in section II.b of Appendix B of the 2013 final rule prescribe the establishment, maintenance and enforcement of a compliance program that includes written policies and procedures that are appropriate for the type, size, complexity, and risks of the covered fund and related activities conducted and investments made, by a banking entity. In addition to the requirements of § __.20, § II.b of Appendix B requires that compliance programs be designed to: (1) include appropriate management review and independent testing for identifying and documenting covered funds in which the banking entity invests, or that each unit within the banking entity's organization sponsors or organizes and offers, and covered funds in which each such unit invests; (2) identify, document, and map each unit within the organization that is permitted to acquire or hold an interest in any covered fund or sponsor any covered fund; (3) explain the banking entity's strategy for monitoring, mitigating, or prohibiting conflicts of interest, transactions or covered fund activities and investments that may threaten safety and soundness, and exposure to high-risk assets and trading strategies presented by its covered fund activities and investments; (4) document the covered fund activities and investments that each organizational unit is authorized to conduct, the banking entity's plan for actively seeking unaffiliated investors to ensure that any investment by the banking entity conforms to the limits contained in section 12 or registered in compliance with the securities laws and is thereby exempt from those limits within the time periods allotted in section 12, and how it complies with the requirements of subpart C; (5) establish, maintain, and enforce internal controls that are reasonably designed to ensure that the banking entity's covered fund activities or investments are

compliant and to detect potential compliance violations; and (6) identify, document, address, and remedy any compliance violations.

The 2013 final rule subjects certain banking entities to the enhanced minimum compliance standards of Appendix B to reflect the Agencies' expectation that banking entities with significant covered fund activities or investments adopt sophisticated compliance regimes. However, the Agencies recognize that operationalizing these requirements may restrict the flexibility of banking entities to adapt their existing risk management frameworks for purposes of compliance with the 2013 final rule. The Agencies believe that a banking entity with significant trading assets and liabilities or moderate trading assets and liabilities currently subject to Appendix B requirements could effectively implement an appropriately robust compliance program by tailoring the requirements of § __.20 to the type, size, scope, and complexity of its covered fund activities and business structure. Accordingly, the Agencies propose to eliminate the requirements of § II.b of Appendix B to the 2013 final rule.

Under the proposal, a banking entity with significant trading assets and liabilities or with moderate trading assets and liabilities would satisfy the compliance program requirements by appropriately scaling the compliance program requirements in § __.20. A banking entity with significant trading assets and liabilities would also be required to adopt the covered fund documentation requirements in § __.20(e) of the proposal.

The Agencies believe that, under the proposal, compliance programs that satisfy the foregoing requirements and that are appropriately tailored to the size, scope, and complexity of the banking entity's activities, would be effective in meeting the objectives underlying the enhanced requirements set forth in Appendix B of the 2013 final rule with respect to covered fund investments and activities. Furthermore, affording banking entities the flexibility to adapt

their existing risk management frameworks to satisfy the § __.20 compliance program requirements would reduce the complexity of compliance with section 13 of the BHC Act.

Question 211. The Agencies are requesting comment on whether the requirements of § __.20 of the proposal would, if appropriately tailored to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities comply with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations. In addition to CEO attestation requirement in proposed § ___.20(c), are there certain requirements included in Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading assets and liabilities, in order to ensure compliance with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations? To what extent would the elimination of Appendix B reduce the complexity of compliance with section 13 of the BHC Act? What other options should the Agencies consider in order to reduce complexity while still ensuring robust compliance with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations?

Question 212. How do banking entities that are registered investment advisers currently meet their compliance program obligations? That is, to what extent are banking entities' compliance programs related to the covered fund prohibitions of the 2013 final rule implemented by the registered investment adviser as opposed to the other affiliates or subsidiaries that are part of the banking entity? How costly are the existing compliance program requirements for banking entities that are registered investment advisers, broken down based on whether they are categorized as having significant, moderate, and limited trading assets and liabilities under the

proposal? How would those annual costs change if the modifications described in the proposal were adopted?

iv. **Responsibility and Accountability**

Appendix B of the 2013 final rule contains a CEO attestation requirement as part of the enhanced minimum standards for compliance programs as a means to ensure that a strong governance framework is implemented with respect to compliance with section 13 of the BHC Act. This provision requires a banking entity's CEO to 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 final rule in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and the 2013 final rule. Appendix B of the 2013 final rule also specifies 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.

Consistent with the Agencies' proposal to remove the specific, enhanced minimum standards included in Appendix B of the 2013 final rule, the Agencies propose to incorporate the CEO attestation requirement within § __.20(c) so that it will to apply to banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities. Further, the Agencies propose that the CEO attestation requirement in § __.20(c) specify 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.

Preserving the CEO attestation requirement and incorporating it within the proposal underscores the importance of CEO engagement within the overall compliance framework for banking entities with significant trading assets and liabilities and for banking entities with moderate trading assets and liabilities. The Agencies believe that the CEO attestation requirement may reinforce the importance of creating and communicating an appropriate "tone at the top," setting an appropriate culture of compliance, and establishing clear policies regarding the management of the firm's covered trading activities and its covered fund activities and investments.

The Agencies believe that incorporating the CEO attestation requirement into proposed § __.20(c) could 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, while the 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.

Question 213. The Agencies are requesting comment on whether incorporating the CEO attestation requirement in proposed § __.20(c) would ensure that a strong governance framework is implemented with respect to compliance with section 13 of the BHC Act and the proposal. What other options should the Agencies consider in order to encourage CEO engagement in ensuring robust compliance with section 13 of the BHC Act and the proposal?

v. **Independent Testing**

After careful consideration, the Agencies propose to eliminate the specific enhanced minimum standards for independent testing prescribed in Appendix B, section IV of the 2013 final rule and permit banking entities with significant trading assets and liabilities to satisfy the compliance program requirements by meeting the independent testing requirements outlined in § __.20(b)(4) of the proposal. Section __.20(b)(4) of the proposal specifies that the contents of the compliance program shall include 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. As with all elements of the required compliance program under proposed § __.20(b), independent testing should be designed and implemented in a manner that is appropriate for the type, size, scope, and complexity of activities and business structure of the banking entity. Section __.20(b)(4) allows for a tailored approach to ensure that the effectiveness of the compliance program is subject to an objective review with appropriate frequency and depth. Under the proposal, a banking entity with moderate trading assets and liabilities would be permitted to incorporate independent testing into its existing compliance programs as appropriate given the activities, size, scope, and complexity of the banking entity.

vi. **Training**

After careful consideration, the Agencies propose to eliminate the training element of the enhanced compliance program of Appendix B, section V of the 2013 final rule and permit banking entities to satisfy compliance program requirements by meeting the training requirements outlined in § __.20(b)(5) of the proposal. Section __.20(b)(5) specifies that the contents of the compliance program shall include training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program. As with all elements of the required compliance program under § __.20(b), the Agencies expect the training regimen to be designed and implemented in a manner that is

appropriate for the type, size, scope, and complexity of activities and business structure of the banking entity. Under the proposal, a banking entity with moderate trading assets and liabilities would be permitted to incorporate training into its existing compliance programs as appropriate given the activities, size, scope and complexity of the banking entity.

vii. **Recordkeeping**

Appendix B, section VI of the 2013 final rule requires banking entities to create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. After careful consideration, the Agencies believe that the enhanced minimum standards under Appendix B, section VI can be replaced by the requirements prescribed in § __.20(b)(6) of the proposal. Section __.20(b)(6) of the proposal specifies that the banking entity must establish records sufficient to demonstrate compliance with section 13 of the BHC Act and subpart D and promptly provide to the relevant Agency upon request and retain such records for no less than 5 years or for such longer period as required by the relevant Agency. As with all elements of the required compliance program under § __.20(b), the Agencies expect the record keeping requirement to be designed and implemented in a manner that is appropriate for the type, size, scope, and complexity of activity and business structure of the banking entity. A banking entity with moderate trading assets and liabilities would be permitted to incorporate recordkeeping into its existing compliance programs as appropriate given the activities, size, scope, and complexity of the banking entity.

Question 214. The Agencies are requesting comment on whether the existing independent testing, training, and recordkeeping requirements of § __.20(b) would, if appropriately tailored to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant trading assets and liabilities and moderate trading assets and liabilities comply with the requirements and restrictions of section

13 of the BHC Act and the implementing regulations. Are there certain requirements included in independent testing, training, and recordkeeping requirements of Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading, in order to ensure compliance with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations? To what extent would the elimination of the independent testing, training, and recordkeeping requirements of Appendix B reduce the complexity of complying with section 13 of the BHC Act? What other options should the Agencies consider with respect to independent testing, training, and recordkeeping in order to reduce complexity while still ensuring robust compliance with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations?

e. Summary of Proposed Revisions to Compliance Program Requirements

The following table provides a summary of the proposed changes to the compliance program requirements:

Summary of Proposed Changes to Compliance Program Requirements		
Requirement (citation to 2013 final rule)	**Banking Entities Subject to Requirement in 2013 final rule**	**Banking Entities Subject to Requirement in Proposal**
6 Pillar Compliance Program (**Section __.20(b)**)	Banking entities with more than $10 billion in total consolidated assets	Banking entities with significant trading assets and liabilities
Enhanced compliance program (**Section __.20(c), Appendix B**)	Banking entities with: • $50 billion or more in total consolidated assets, or • Trading assets and liabilities of $10 billion or greater over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, if the banking entity engages in proprietary trading activity	Not applicable. Enhanced compliance program eliminated (but see CEO Attestation Requirement below).

	permitted under subpart B. • Additionally, any other banking entity notified in writing by the Agency	
CEO Attestation Requirement (**Section __.20(c), Appendix B**)	Banking entities with: • $50 billion or more in total consolidated assets, or • Trading assets and liabilities of $10 billion or greater over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters. • Additionally, any other banking entity notified in writing by the Agency	• Banking entities with significant trading assets and liabilities • Banking entities with moderate trading assets and liabilities • Any other banking entity notified in writing by the Agency
Metrics Reporting Requirements (**Section __.20(d), Appendix A**)	• Banking entities with 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 prior calendar quarters, is $10 billion or greater, if the banking entity engages in proprietary trading activity permitted under subpart B. • Any other banking entity notified in writing by the Agency	• Banking entities with significant trading assets and liabilities • Any other banking entity notified in writing by the Agency
Additional covered fund documentation requirements (**Section __.20(e))**	Banking entities with more than $10 billion in total consolidated assets as reported on December 31 of the previous two calendar years	Banking entities with significant trading assets and liabilities
Simplified program for banking entities with no covered activities (**Section __.20(f)(1)**)	Banking entities that do not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B)	Banking entities that do not engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B)
Simplified program for banking entities	Banking entities with $10 billion or less in total	Banking entities with moderate trading assets and liabilities

with modest activities (**Section __.20(f)(2)**)	consolidated assets as reported on December 31 of the previous two calendar years that engage in activities or investments pursuant to subpart B or subpart C (other than trading activities permitted pursuant to § __.6(a) of subpart B)	
No compliance program requirement unless Agency directs otherwise (**N/A**)	Not applicable.	Banking entities with limited trading assets and liabilities subject to the presumption of compliance

E. Appendix to Part [●]—Reporting and Recordkeeping Requirements

1. Overview of the Proposal and Significant Changes from the 2013 final rule

As provided in the preamble to the 2013 final rule, the Agencies have assessed the metrics data for its effectiveness in monitoring covered trading activities for compliance with section 13 of the BHC Act and for its costs.[215] The Agencies have also considered whether all of the quantitative measurements are useful for all asset classes and markets, as well as for all the trading activities subject to the metrics requirement, or whether modifications are appropriate.[216] As a result of this evaluation, and as described in detail below, the Agencies are proposing the following amendments to Appendix A of the 2013 final rule:[217]

- 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 quantitative measurements already reported.

[215] *See* 79 FR at 5772.

[216] *Id*.

[217] In connection with the Appendix, the following documents have also been published and made available on each Agency's respective website: Instructions for Preparing and Submitting Quantitative Measurement Information ("Instructions"), Technical Specifications Guidance, and an eXtensible Markup Language Schema ("XML Schema").

- 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.[218]
- 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.

[218] The Instructions are 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, and neither Commission has approved nor disapproved the Staff Instructions for Preparing and Submitting Quantitative Measurement Information.

- 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.[219]

Taken together, these changes – particularly limiting the applicability of certain metrics requirements only to trading desks engaged in certain types of covered trading activity – are designed to reduce compliance-related inefficiencies relative to the 2013 final rule. The proposed amendments to Appendix A of the 2013 final rule should allow collection of data that permits the Agencies to better monitor compliance with section 13 of the BHC Act. [220]

2. Summary of the Proposal

a. Purpose

Paragraph I.c of Appendix A of the 2013 final 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 Agencies propose to expand paragraph I.c of Appendix A of the 2013 final rule to cover all information that must be furnished pursuant to the appendix, rather than only to the quantitative measurements themselves. [221]

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[219] 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**.

[220] As previously noted in the section entitled "Enhanced Minimum Standards for Compliance Programs," the Agencies are proposing to eliminate Appendix B of the 2013 final rule. If that aspect of the proposal is adopted, current Appendix A, as modified by the proposal, would be re-designated as the "Appendix."

[221] The proposed amendment to paragraph I.c. of Appendix A would make clear that none of the information that a banking entity would be required to report under the proposal is intended to serve as a dispositive tool for identifying permissible or impermissible activities. Currently, that qualifying language only applies to the quantitative measurements. As proposed, that

The Agencies propose to remove paragraph I.d. in Appendix A of the 2013 final rule, which provides for an initial review by the Agencies of the metrics data and revision of the collection requirement as appropriate. The Agencies have conducted this preliminary evaluation of the effectiveness of the quantitative measurements collected to date and are proposing modifications to Appendix A of the 2013 final rule where appropriate. The Agencies are, however, requesting comment on whether the rule should provide for a subsequent Agency review within a fixed period of time after adoption to consider whether further changes are warranted. The Agencies further note that they continue to monitor and review the effectiveness of the data as part of their ongoing oversight of the banking entities and will continue to do so should the proposed changes to Appendix A be adopted.

b. Definitions

The Agencies are proposing a clarifying change to the definition of "covered trading activity." The Agencies are proposing to add 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(e), __.6(c), __.6(d), or __.6(e) of the proposal. The proposed change would simply clarify that banking entities would have the discretion (but not the obligation) to report metrics with respect to a broader range of activities.

In addition, the proposal defines two additional terms for purposes of the appendix, "applicability" and "trading day," that were not defined in the 2013 final rule. In particular, the proposal provides:

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information would continue to be used to monitor patterns and identify activity that may warrant further review.

- *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.
- *Trading day* means a calendar day on which a trading desk is open for trading.

"Applicability" is defined in this proposal to clarify when certain metrics are required to be reported for specific trading desks. As described further below, this proposal would make several metrics applicable only to desks engaged in market making or underwriting.

The Agencies are proposing to create a definition of "trading day" to clarify the meaning of a term that is used throughout Appendix A of the 2013 final rule. Appendix A provides that the calculation period for each quantitative measurement is one trading day. The proposal would make clear that a banking entity would be required to calculate each metric for each calendar day on which a trading desk is open for trading.[222] If a trading desk books positions to a banking entity on a calendar day that is not a business day (e.g., a day that falls on a weekend), then the desk is considered open for trading on that day. Even if a trading desk does not conduct any trades on a business day, the banking entity would be required to report metrics on the trading desk's existing positions for that calendar day because the trading desk is open to conduct trading. Similarly, if a trading desk spans a U.S. entity and a foreign entity and a national holiday occurs on a business day in the United States but not in the foreign jurisdiction (or vice versa), the banking entity would be required to report metrics for the trading desk on that calendar day because the trading desk is open to conduct trading in at least one jurisdiction. The Agencies believe that the proposed definition of trading day is both objective and transparent,

[222] As a general matter, a trading desk is not considered to be open for trading on a weekend.

while also providing flexibility to banking entities by tying the definition directly to the schedule in which they operate their trading desks.

The Agencies request comments on the definitions in this proposal, including comments on the following questions:

Question 215. Is the proposed definition of "Applicability" effective and clear? If not, what alternative definition would be more effective and/or clearer?

Question 216. Is the proposed definition of "Trading day" effective and clear? If not, what alternative definition would be more effective and/or clearer?

Question 217. Is the proposed modification of "Covered trading activity" effective and clear? If not, what alternative definition would be more effective and/or clearer?

Question 218. Should any other terms be defined? If so, are there existing definitions in other rules or regulations that could be used in this context? Why would the use of such other definitions be appropriate?

c. Reporting and Recordkeeping

i. **Scope of Required Reporting**

The Agencies are proposing several modifications to paragraph III.a of Appendix A of the 2013 final rule. The Agencies are proposing to remove the Inventory Turnover and Customer-Facing Trade Ratio metrics and replace them with the Positions and Transaction Volumes quantitative measurements, respectively. In addition, as discussed below, the proposal provides that the Inventory Aging metric would only apply to securities, and would not apply to derivatives or securities that also meet the 2013 final rule's definition of a derivative.[223] As a result, the Agencies are proposing to change the name of the Inventory Aging quantitative

[223] *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 final rule. *See* 2013 final rule §§ __.2 (h), (y).

measurement to the Securities Inventory Aging metric. Moreover, as described in more detail below, the Agencies are proposing amendments to Appendix A that would limit the application of certain quantitative measurements to trading desks that engage in specific covered trading activities.[224] As a result, the Agencies are proposing to add the phrase "as applicable" to paragraph III.a.[225] Finally, the Agencies are proposing to add references in paragraph III.a to the proposed Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement requirements.[226]

d. Trading Desk Information

The Agencies are proposing to add new paragraph III.b to Appendix A to require banking entities to report certain descriptive information regarding each trading desk engaged in covered trading activity:

i. Trading desk name and trading desk identifier

Under paragraph III.b. of the proposed Appendix, the banking entity would be required to provide the trading desk name and trading desk identifier for each desk engaged in covered trading activities. While this proposed requirement may affect the banking entity's overall reporting obligations, this identifying information should enable the Agencies to track a banking

[224] As discussed below, the proposed Positions, Transaction Volumes, and Securities Inventory Aging quantitative measurements generally apply only to trading desks that rely on § __.4(a) or § __.4(b) to conduct underwriting activity or market making-related activity, respectively. *See infra* Part III.E.2.*i*.iii (discussing the Positions, Transaction Volumes, and Securities Inventory Aging quantitative measurements).

[225] *See* 79 FR at 5616.

[226] In addition, the Agencies propose to add 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 final rule. File identifying information reflects administrative information needed to identify the reporting requirement that is being met and distinguish between files submitted pursuant to Appendix A. File identifying information must 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.

entity's trading desk structure over time, which the Agencies believe will help identify situations when a significant data change is the result of a structural change and assist the Agencies' ability to monitor patterns in the quantitative measurements. The Agencies also believe that the proposed qualitative information, including the items identified in the sections below, potentially could provide the Agencies with enough contextual basis to facilitate the examination and supervisory processes. Such context also could potentially lessen the need for Agency follow-up in when a red flag is identified.

The trading desk name must be the name of the trading desk used internally by the banking entity. The trading desk identifier is a unique identification label that should be permanently assigned to a desk by the banking entity. A trading desk at a banking entity may not have the same trading desk identifier as another desk at that banking entity. The trading desk identifier that is assigned to each desk should remain the same for each submission of quantitative measurements. In the event a banking entity restructures its operations and merges two or more trading desks, the banking entity should assign a new trading desk identifier to the merged desk (i.e., the merged desk's identifier should not replicate a trading desk identifier assigned to a previously unmerged trading desk) and permanently retire the unmerged desks' identifiers. Similarly, if a banking entity eliminates a trading desk, the trading desk identifier assigned to the eliminated desk should be permanently retired (i.e., the eliminated desk's identifier should not be reassigned to a current or future trading desk).

Question 219. Should the Agencies require banking entities to report changes in desk structure in the XML reporting format in addition to a description of the changes in the Narrative Statement? For example, a "change event" element could be added to the proposal that would link the trading desk identifiers of predecessor and successor desks before and after trading desk

mergers and splits. Would the modifications improve the banking entities' and the Agencies' ability to track changes in trading desk structure and strategy across reporting periods? How significant are any potential costs relative to the potential benefits in facilitating the tracking of trading desk changes? Please quantify your answers, to the extent feasible.

ii. Type of covered trading activity

Proposed paragraph III.b. would require a banking entity to identify each type of covered trading activity that the trading desk conducts. As previously discussed, the proposal defines "covered trading activity," in part, as trading conducted by a trading desk under §§ __.4, __.5, __.6(a), or __.6(b).[227] To the extent a trading desk relies on one or more of these permitted activity exemptions, the banking entity would be required to identify the type(s) of covered trading activity (e.g., underwriting, market making, risk-mitigating hedging, etc.) in which the trading desk is engaged.

The proposed definition of "covered trading activity" also provides that a banking entity may include in its covered trading activity trading conducted under §§ __.3(e), __.6(c), __.6(d), or __.6(e). If a trading desk relies on any of the exclusions discussed in § __.3(e) or the permitted activity exemptions discussed in §§ __.6(c) through __.6(e) and the banking entity includes such activity as "covered trading activity" for the desk under the proposed Appendix, the banking entity would need to identify these activity types (e.g., securities lending, liquidity management, fiduciary transactions, etc.) for the trading desk.

While this proposed requirement may impact a firm's overall reporting obligations, the Agencies believe the identification of each desk's covered trading activity will help the relevant Agency establish the appropriate scope of examination of such activity and assist with

[227] *See supra* Part III.E.2.b (discussing the covered trading activity definition).

identifying the relevant exemptions or exclusions for a particular trading desk, which in turn enables an evaluation of a desk's reported data in the context of those exemptions or exclusions.

iii. Trading desk description

Proposed paragraph III.b. would require a banking entity to provide a description of each trading desk engaged in covered trading activities. Specifically, the banking entity would be required to provide a brief description of the trading desk's general strategy (i.e., the method for conducting authorized trading activities). The Agencies believe this descriptive information would improve the Agencies ability to assess the risks associated with a given covered trading activity and would further assist the relevant Agency in determining the appropriate frequency and scope of examination of such activity.

iv. Types of financial instruments and other products

Proposed paragraph III.b. would require a banking entity to provide descriptive information regarding the financial instruments and other products traded by each desk engaged in covered trading activities. Under the proposal, a banking entity would be required to prepare a list identifying all the types of financial instruments purchased and sold by the trading desk.[228] The banking entity may include other products that are not defined as financial instruments under § __.3(c)(1) of the 2013 final rule in this list. In addition, the proposal requires a banking entity to indicate which of these financial instruments and other products (if applicable) are the main instruments and products purchased and sold by the trading desk. If the trading desk relies on the permitted activity exemption for market making-related activities, the banking entity would

[228] For example, a banking entity may specify that its high grade credit trading desk purchases and sells the following types of financial instruments: U.S. corporate debt, convertible bonds, credit default swaps, and credit default swap indices.

be required to specify whether each type of financial instrument included in the listing of all financial instruments is or is not included in the trading desk's market-making positions.[229]

The proposal also addresses "excluded products" traded by desks engaged in covered trading activities. The definition of the term "financial instrument" in the 2013 final rule does not include loans, spot commodities, and spot foreign exchange or currency (collectively, "excluded products").[230] While positions in excluded products are not subject to the 2013 final rule's restrictions on proprietary trading, a banking entity may decide to include exposures in excluded products that are related to a trading desk's covered trading activities in its quantitative measurements.[231] A banking entity generally should use a consistent approach for including or excluding positions in products that are not financial instruments when calculating metrics for a trading desk.[232]

In recognition that a banking entity may include excluded products in its quantitative measurements, proposed paragraph III.b. would require a banking entity to indicate whether each

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[229] The term "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 § __.4(b)(2)(i) of the proposal, that are managed by the trading desk, including the trading desk's open positions or exposures arising from open transactions. *See* proposal § __.4(b)(5).

[230] *See* 2013 final rule § __.3(c)(2).

[231] The Agencies note that banking entities are not required to calculate quantitative measurements based on positions in products that are not "financial instruments," as defined under § __.3(c)(2) of the 2013 final rule, or positions that do not represent "covered trading activity." However, a banking entity may decide to include exposures in products that are not financial instruments in a trading desk's calculations where doing so provides a more accurate picture of the risks associated with the trading desk. For example, a market maker in foreign exchange forwards or swaps that mitigates the risks of its market-maker inventory with spot foreign exchange may include spot foreign exchange positions in its metrics calculations.

[232] A banking entity generally should not incorporate excluded products in the quantitative measurements of a trading desk one month, and omit these products from the trading desk's measurements the following month. Excluded products generally should be reported consistently from period to period. Any change in reporting practice for excluded products must be identified in the banking entity's Narrative Statement for the relevant trading desk(s). *See infra* Part III.E.2.f (discussing the Narrative Statement).

trading desk engaged in covered trading activities is including excluded products in its quantitative measurements. If excluded products are included in a trading desk's metrics, the banking entity would have to identify the specific products that are included.

This information should enable the Agencies to better understand the scope of covered trading activities, and thus help in identifying the profile of particular covered trading activities of a banking entity and its individual trading desks. Such identification is necessary to establish the appropriate frequency and scope of examination by the relevant Agency of such activity, evaluate whether a banking entity's covered trading activity is consistent with the 2013 final rule, and assess the risks associated with the activity.

v. Legal entities the trading desk uses

As discussed in the preamble to the 2013 final rule, the Agencies recognize that a trading desk may book positions into a single legal entity or into multiple affiliated legal entities.[233] To assist in establishing the appropriate scope of examination by the relevant Agency of a banking entity's covered trading activities, the Agencies are proposing to require each banking entity to identify each legal entity that serves as a booking entity for each trading desk engaged in covered trading activities, and to indicate which of these legal entities are the main booking entities for covered trading activities of each desk. The banking entity would have to provide the complete name for each legal entity (i.e., the banking entity could not use abbreviations or acronyms), and the banking entity would have to provide any applicable entity identifiers.[234]

vi. Legal entity type identification

[233] 79 FR at 5591.

[234] The Agencies are not proposing to require each legal entity that serves as a booking entity to obtain an entity identifier to comply with the proposed appendix. If a legal entity does not have an applicable entity identifier, it should report "None" in the appropriate field.

The Agencies are proposing to require each banking entity to specify any applicable entity type for each legal entity that serves as a booking entity for trading desks engaged in covered trading activities. The proposal provides a list of key entity types for this purpose. For example, if a trading desk books trades into a legal entity that is a U.S.-registered broker-dealer, the banking entity would indicate "U.S.-registered broker-dealer" in the entity type identification field for that particular trading desk. If more than one entity type applies to a particular legal entity that serves as a booking entity, the banking entity must specify any applicable entity type for that legal entity. For example, if a trading desk books trades into a legal entity that is a U.S.-registered broker-dealer and a registered futures commission merchant, the banking entity would indicate "U.S.-registered broker-dealer" and "futures commission merchant" in the entity type identification field for that particular trading desk.

The proposal also requires that a banking entity identify entity types that are not otherwise enumerated in the proposed Appendix, including a subsidiary of a legal entity that is listed where the subsidiary itself is not included in the list. For example, the Agencies understand that a trading desk may book some or all of its positions into a legal entity that is incorporated under foreign law. In this situation, the banking entity should provide a brief description of the entity (e.g., foreign-registered securities dealer) in the entity type identification field for that trading desk. The Agencies believe that the information collected under this section would assist banking entities and the Agencies in monitoring and understanding the scope of covered trading activities. In particular, the proposed entity type information, in conjunction

with the identification of legal entities used by the trading desk (discussed above), would facilitate the Agencies' ability to coordinate with each other, as appropriate.[235]

vii. Trading day indicator

In order to facilitate metrics reporting, paragraph III.b. of the proposed Appendix requires a banking entity to indicate whether each calendar date is a trading day or not a trading day for each trading desk engaged in covered trading activities. The Agencies believe that this information would assist banking entities and the Agencies in monitoring covered trading activities. Specifically, the identification of trading days and non-trading days will allow the Agencies to understand why metrics may not be reported on a particular day for a particular trading desk. In addition, the Agencies expect that this information would improve consistency in metrics reports by requiring banking entities to determine whether metrics are, or are not, required to be reported for each calendar day.

viii. Currency reported and currency conversion rate

In recognition that a banking entity may report quantitative measurements for a trading desk engaged in covered trading activities in a currency other than U.S. dollars, paragraph III.b. of the proposed Appendix requires a banking entity to specify the currency used by that trading desk as well as the conversion rate to U.S. dollars. Under the proposal, the banking entity would be required to provide the currency reported on a monthly basis and the currency conversion rate for each trading day. The Agencies believe this information would assist banking entities and the Agencies in monitoring covered trading activities by facilitating the identification of quantitative measurements reported in a currency other than U.S. dollars and the conversion of

[235] *See* 79 FR at 5758. The Agencies expect to continue to coordinate their efforts related to section 13 of the BHC Act and to share information as appropriate in order to effectively implement the requirements of that section and the 2013 final rule. *See id.*

such measurements to U.S. dollars. The ability to convert a banking entity's reported quantitative measurements into one consistent currency enhances the ability of the Agencies to evaluate the metrics and facilitates cross-desk comparisons.

Question 220. Is the description of the proposal's Trading Desk Information requirement effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific guidance necessary? If so, what level of specificity is needed to prepare the proposed Trading Desk Information? If the proposed Trading Desk Information is not sufficiently specific, how should it be modified to reach the appropriate level of specificity? If the proposed Trading Desk Information is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?

Question 221. Is the proposed Trading Desk Information helpful to understanding the scope, type, and profile of a trading desk's covered trading activities and associated risks? Why or why not? Does the proposed Trading Desk Information appropriately highlight relevant changes in a banking entity's trading desk structure and covered trading activities over time? Why or why not? Do banking entities expect that the proposed Trading Desk Information would reduce, increase, or have no effect on the number of information requests from the Agencies regarding the quantitative measurements? Please explain.

Question 222. Is any of the information required by the proposed Trading Desk Information already available to banking entities? Please explain.

Question 223. Does the proposed Trading Desk Information strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?

Question 224. Are there burdens or costs associated with preparing the proposed Trading Desk Information, and if so, how burdensome or costly would it be to prepare such information? What are the additional burdens or costs associated with preparing this information for particular trading desks? How significant are those potential costs relative to the potential benefits of the information in understanding the scope, type, and profile of a trading desk's covered trading activities and associated risks? Are there potential modifications that could be made to the proposed Trading Desk Information that would reduce the burden or cost while achieving the purpose of the proposal? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Question 225. In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to prepare the proposed Trading Desk Information (e.g., collect data and map legal entities)? Do commenters anticipate the need to develop additional infrastructure to obtain and retain data necessary to prepare this schedule? Please explain and quantify your answers, to the extent feasible.

Question 226. What operational or logistical challenges might be associated with preparing the proposed Trading Desk Information and obtaining any necessary informational inputs?

Question 227. How might the proposed Trading Desk Information affect the behavior of banking entities? To what extent and in what ways might uncertainty as to how the Agencies will review and evaluate the proposed Trading Desk Information affect the behavior of banking entities?

Question 228. Is the meaning of the term "main," as that term is used in the proposed Trading Desk Information (e.g., main financial instruments or products, main booking entities), effective and sufficiently clear? If not, how should the Agencies define this term such that it is more effective and/or clearer? Should the meaning of the term "main" be the same with respect to: (i) main financial instruments or other products; and (ii) main booking entities? Why or why not?

Question 229. In addition to reporting "main" financial instruments or products and "main" booking entities, should banking entities be required to report the amount of profit and loss attributable to each "main" financial instrument or product and/or "main" booking entity utilized by the trading desk in the Trading Desk Information? Why or why not?

Question 230. Is the proposal's requirement that a banking entity identify all financial instruments or other products traded on a desk effective and clear? Why or why not? Should the Agencies provide a specific list of financial instruments or other product types from which to choose when identifying financial instruments or other products traded on a desk? If so, please provide examples.

Question 231. Should banking entities be required to report at least one valid unique entity identifier (e.g., LEI, CRD, RSSD, or CIK) for each legal entity identified as a booking entity for covered trading activities of a desk? How burdensome and costly would it be for a banking entity to obtain an entity identifier for each legal entity serving as a booking entity that does not already have an identifier? What are the additional burdens or costs associated with obtaining an entity identifier for particular legal entities? How significant are those potential costs relative to the potential benefits in facilitating the identification of legal entities? Please quantify your answers, to the extent feasible.

Question 232. Is more guidance needed on what a banking entity should report in response to the proposed requirement to specify the applicable entity type(s) for each legal entity that serves as a booking entity for covered trading activities of a trading desk? If so, please explain.

Question 233. How burdensome and costly would it be for banking entities to report which Agencies receive reported quantitative measurements for each specific trading desk?

e. Quantitative Measurements Identifying Information

The Agencies are proposing to add new paragraph III.c. to the proposed Appendix to require banking entities to prepare and report descriptive information regarding their quantitative measurements. This information would have to be reported collectively for all relevant trading desks. For example, a banking entity would report one Risk and Position Limits Information Schedule, rather than separate Risk and Position Limits Information Schedules for each of those trading desks.

i. Risk and Position Limits Information Schedule

The proposed Risk and Position Limits Information Schedule requires banking entities to provide detailed information regarding each limit reported in the Risk and Position Limits and Usage quantitative measurement, including the unique identification label for the limit, the limit name, limit description, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit. The unique identification label for the limit should be a character string identifier that remains consistent across all trading desks and reporting periods. When reporting the type of limit, the banking entity would identify which of the following categories best describes the limit: Value-at-Risk, position limit, sensitivity limit, stress scenario, or other. If "other" is reported, the banking entity would provide a brief description of the type of limit. The Agencies believe this

more detailed limit information would enable the Agencies to better understand how banking entities assess and address risks associated with their covered trading activities.

ii. Risk Factor Sensitivities Information Schedule

The proposed Risk Factor Sensitivities Information Schedule requires banking entities to provide detailed information regarding each risk factor sensitivity reported in the Risk Factor Sensitivities quantitative measurement, including the unique identification label for the risk factor sensitivity, the name of the risk factor sensitivity, a description of the risk factor sensitivity, and the risk factor sensitivity's risk factor change unit. The unique identification label for the risk factor sensitivity should be a character string identifier that remains consistent across all trading desks and reporting periods. The risk factor change unit is the measurement unit of the risk factor change that impacts the trading desk's portfolio value.[236] This proposed schedule should enable the Agencies to better understand the exposure of a banking entity's trading desks to individual risk factors.

iii. Risk Factor Attribution Information Schedule

The proposed Risk Factor Attribution Information Schedule requires banking entities to provide detailed information regarding each attribution of existing position profit and loss to risk factor reported in the Comprehensive Profit and Loss Attribution quantitative measurement, including the unique identification label for each risk factor or other factor attribution, the name of 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. The unique identification label for the risk factor or other factor attribution should be a character string identifier that remains consistent across all trading desks

[236] For example, the risk factor change unit for the dollar value of a one-basis point change (DV01) could be reported as "basis point." Similarly, the risk factor change unit for equity delta could be reported as "dollar change in equity prices" or "percentage change in equity prices."

and reporting periods. The factor change unit is the measurement unit of the risk factor or other factor change that impacts the trading desk's portfolio value.[237] This proposed schedule should improve the Agencies' understanding of the individual risk factors and other factors that contribute to the daily profit and loss of trading desks engaged in covered trading activities.

iv. Limit/Sensitivity Cross-Reference Schedule

The Agencies recognize that risk factor sensitivities that are reported in the Risk Factor Sensitivities quantitative measurement frequently relate to, or are associated with, risk and position limits that are reported in the Risk and Position Limits and Usage metric. In recognition of the relationship between risk and position limits and associated risk factor sensitivities, the Agencies propose an amendment to Appendix A of the 2013 final rule that would require banking entities to prepare a Limit/Sensitivity Cross-Reference Schedule. Specifically, banking entities would be required 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.

Highlighting the relationship between limits and risk factor sensitivities should provide a broader picture of a trading desk's covered trading activities and improve the Agencies' understanding of the quantitative measurements. For example, the proposed Limit/Sensitivity Cross-Reference Schedule should help the Agencies better evaluate a reported limit on a risk factor sensitivity by allowing the Agencies to efficiently identify additional contextual information about the risk factor sensitivity in the banking entity's metrics submission.

v. Risk Factor Sensitivity/Attribution Cross-Reference Schedule

[237] *See supra* note 236.

The Agencies note that the specific risk factors and other factors that are reported in the Comprehensive Profit and Loss Attribution quantitative measurement may relate to the risk factor sensitivities reported in the Risk Factor Sensitivities metric. As a result, the Agencies are proposing an amendment to Appendix A of the 2013 final rule that would require banking entities to prepare a Risk Factor Sensitivity/Attribution Cross-Reference Schedule. Specifically, banking entities would be required to cross-reference, by unique identification label, a risk factor sensitivity reported in the Risk Factor Sensitivities Information Schedule to any associated risk factor attribution reported in the Risk Factor Attribution Information Schedule. This proposed cross-reference schedule is intended to clarify the relationship between risk factors that serve as sensitivities and the profit and loss that is attributed to those risk factors. In conjunction with the Limit/Sensitivity Cross-Reference Schedule, the Risk Factor Sensitivity/Attribution Cross-Reference Schedule should assist the Agencies in understanding the broader scope, type, and profile of a banking entity's covered trading activities and assessing associated risks, and facilitate the relevant Agency's efforts in monitoring those covered trading activities. For example, the proposed Risk Factor Sensitivity/Attribution Cross-Reference Schedule should help the Agencies compare the variables that a banking entity has identified as significant sources of its trading desks' profitability and risk for purposes of the Risk Factor Sensitivities metric to the factor(s) that account for actual changes in the banking entity's trading desk-level profit and loss, as reported in the Comprehensive Profit and Loss Attribution metric. This comparison will allow the Agencies to evaluate whether a banking entity has identified risk factors in the Risk Factor Sensitivities metric of a trading desk that help explain the trading desk's profit and loss.

Question 234. Is the information required by the proposed Quantitative Measurements Identifying Information effective and sufficiently clear? If not, what alternative would be more

effective or clearer? Is more or less specific guidance necessary? If so, what level of specificity is needed to prepare the relevant schedule? If the proposed Quantitative Measurements Identifying Information is not sufficiently specific, how should it be modified to reach the appropriate level of specificity? If the proposed Quantitative Measurements Identifying Information is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?

Question 235. Is the information required by the proposed Quantitative Measurements Identifying Information helpful or not helpful to understanding a banking entity's covered trading activities and associated risks? Identify which specific pieces of information are helpful or not helpful and explain why. Does the information provide necessary clarity about a banking entity's risk measures and how such risk measures relate to one another over time and within and across trading desks? Do banking entities expect that the schedules will reduce, increase, or have no effect on the number of information requests from the Agencies regarding the quantitative measurements? Please explain.

Question 236. Is the information required by the proposed Quantitative Measurements Identifying Information already available to banking entities? Please explain.

Question 237. Does the proposed Quantitative Measurements Identifying Information strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?

Question 238. How burdensome and costly would it be to prepare each schedule within the proposed Quantitative Measurements Identifying Information? What are the additional burdens costs associated with preparing these schedules for particular trading desks? How

significant are those potential costs relative to the potential benefits of the schedules in monitoring covered trading activities and assessing risks associated with those activities? Are there potential modifications that could be made to these schedules that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Question 239. In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to prepare the information required by the proposed Quantitative Measurements Identifying Information (e.g., to program information systems and collect data)? Do commenters anticipate the need to develop additional infrastructure to obtain and retain data necessary to prepare these schedules? Please explain and quantify your answers, to the extent feasible.

Question 240. What operational or logistical challenges might be associated with preparing the information required by the proposed Quantitative Measurements Identifying Information and obtaining any necessary informational inputs?

Question 241. How might the proposed Quantitative Measurements Identifying Information affect the behavior of banking entities? To what extent and in what ways might uncertainty as to how the Agencies will review and evaluate the proposed Quantitative Measurements Identifying Information affect the behavior of banking entities?

f. Narrative Statement

The proposed paragraph III.d. requires a banking entity 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 and to indicate when this change occurred. In addition, a banking entity would have to prepare and submit a Narrative Statement when there are any changes in the banking entity's trading desk structure (e.g., adding,

terminating, or merging pre-existing desks) or trading desk strategies. Under these circumstances, the Narrative Statement would have to describe the change, document the reasons for the change, and specify when the change occurred.

Under the proposal, the banking entity would have to report in a Narrative Statement any other information the banking entity views as relevant for assessing the information schedules or quantitative measurements, such as a further description of calculation methods that the banking entity is using. In addition, a banking entity would have to explain its inability to report a particular quantitative measurement in the Narrative Statement. A banking entity also would have to provide notice in its Narrative Statement if a trading desk changes its approach to including or excluding products that are not financial instruments in its metrics.

If a banking entity does not have any information to report in a Narrative Statement, the banking entity would have to submit an electronic document stating that it does not have any information to report in a Narrative Statement.

Question 242. Should the Narrative Statement be required? If so, why? Should the proposed requirement apply to all changes in the calculation methods a banking entity uses for its quantitative measurements or should the proposed rule text be revised to apply only to changes that rise to a certain level of significance? Please explain.

Question 243. Is the proposed Narrative Statement requirement effective and sufficiently clear? If not, what alternative would be more effective or clearer? Are there other circumstances in which a Narrative Statement should be required? If so, what are those circumstances?

Question 244. How burdensome or costly is the proposed Narrative Statement to prepare? Are there potential benefits of the Narrative Statement to banking entities, particularly

as it relates to the ability of banking entities and the Agencies to monitor a firm's covered trading activities?

g. Frequency and Method of Required Calculation and Reporting

The 2013 final 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 final rule within 10 days of the end of each calendar month. The Agencies are proposing to adjust this reporting schedule to extend the time to be within 20 days of the end of each calendar month.[238] Experience with implementing the 2013 final rule has shown that the information submitted within ten days is often incomplete or contains errors. Banking entities must regularly provide resubmissions to correct or complete their initial information submission. This extension of the time for reporting is expected to reduce compliance costs as the additional time would allow the required workflow to be conducted under less time pressure and with greater efficiency and fewer resubmissions should be necessary. The schedule for banking entities with less than $50 billion in trading assets and liabilities would remain unchanged.

Question 245. Is the proposed frequency of reporting the Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement appropriate and effective? If not, what frequency would be more effective? Should the information be required to be reported quarterly, annually, or upon the request of the applicable Agency and, if so, why?

Question 246. Would providing banking entities with additional time to report quantitative measurements meaningfully reduce resubmissions? If so, would the additional time reduce burdens on banking entities? Please provide quantitative data to the extent feasible.

[238] *See* § __.20(d) of the proposal.

Question 247. Is there a calculation period other than daily that would provide more meaningful data for certain metrics? For example, would weekly inventory aging instead of daily inventory aging be more effective? Why or why not?

Appendix A of the 2013 final rule did not specify a format in which metrics should be reported. As a technical matter, banking entities may currently report quantitative measurements to the relevant Agency using various formats and conventions. After consultation with staffs of the Agencies, the reporting banking entities submitted their quantitative measurement data electronically in a pipe-delimited flat file format. However, this flat file format has proved to be unwieldy and its syntactical requirements have been unclear. There has been no easy way for banking entities to validate that their data files are in the correct format before submitting them, and so banking entities have often needed to resubmit their quantitative measurements to address formatting issues.

To make the formatting requirements for the data submissions clearer, and to help ensure the quality and consistency of data submissions across banking entities, the Agencies are proposing to require that the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement be reported in accordance with an XML Schema to be specified and published on the relevant Agency's website.[239] By requiring the XML Schema, the Agencies look to establish a structured model through which reported data can be recognized and processed by standard computer code or software (i.e., made machine-readable). The proposed reporting format should promote complete and intelligible

[239] 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.

records of covered trading activities and facilitate the reporting of key identifying and descriptive information. Submissions structured according to the XML Schema should enhance the Agencies' ability to normalize, aggregate, and analyze reported metrics. In turn, the proposed reporting format should facilitate monitoring of covered trading activities and enable the relevant Agency to more efficiently interpret and evaluate reported metrics. For example, the proposed reporting format should enhance the Agencies' ability to compare data across trading desks and analyze data over different time horizons.

Question 248. How burdensome and costly would it be to develop new systems, or modify existing systems, to implement the proposed Appendix's electronic reporting requirement and XML Schema? How significant are those potential costs relative to the potential benefits of electronic reporting and the XML Schema in facilitating review and analysis of a banking entity's covered trading activities? Are there potential modifications that could be made to the proposal's electronic reporting requirement or XML Schema that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Question 249. Is the proposed XML reporting format for submission of the Trading Desk Information, applicable quantitative measurements, and the Quantitative Measurements Identifying Information appropriate and effective? Why or why not?

Question 250. Is there a reporting format other than the XML Schema that the Agencies should consider as acceptable? Should the Agencies allow banking entities to develop their own reporting formats? If so, are there any general reporting standards that should be included in the rule to facilitate the Agencies' ability to normalize, aggregate, and analyze data that is reported pursuant to different electronic formats or schemas? Please explain in detail.

Question 251. What would be the costs to a banking entity to provide quantitative measurements data according to the proposed XML reporting format? Please quantify your answers, to the extent feasible.

Question 252. For a banking entity currently reporting quantitative measurements in some other electronic format, what would be the costs (such as equipment, systems, training, or ongoing staffing or maintenance) to convert current systems to use the proposed XML reporting format? Please quantify your answers, to the extent feasible.

Question 253. Is there a more effective way to distribute the XML Schema than the current proposal of having each Agency host a copy of the XML Schema on its respective website? For example, would it be more effective for all Agencies to point to only one location where the XML Schema will be hosted? If so, please identify how the alternative would improve data quality and accessibility. How long should the implementation period be?

Question 254. Currently banking entities are reporting quantitative measurements separately to each Agency using tailored data files containing only the measurements for the trading desks that book into legal entities for which an Agency is the primary supervisor. Would it be more effective for all Agencies to use a single point of collection for the quantitative measurements? If so, would there be any impact on Agencies ability to review and analyze a banking entity's covered trading activities? How significant are the costs of reporting separately to each Agency? Please quantify your answers, to the extent feasible. Are there any other ways to make the metrics requirements more efficient? For example, are any banking entities subject to any separate or related data reporting requirements that could be leveraged to make the proposal more efficient?

h. Recordkeeping

Under paragraph III.c. of Appendix A of the 2013 final rule, a banking entity's reported quantitative measurements are subject to the record retention requirements provided in the appendix. Under the proposal, this provision would be in paragraph III.f. of the appendix. The Agencies propose to expand this provision to include the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information in the appendix's record retention requirements.

Question 255. Is the proposed application of Appendix A's record retention requirement to the Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement appropriate? If not, what alternatives would be more appropriate? What costs would be associated with retaining the Narrative Statements and information schedules on that basis, and how could those costs be reduced or eliminated? Please quantify your answers, to the extent feasible.

Question 256. Should the proposed Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement be subject to the same five-year retention requirement that applies to the quantitative measurements? Why or why not? If not, how long should the information schedules and Narrative Statements be retained, and why?

i. Quantitative Measurements

Section IV of Appendix A of the 2013 final rule sets forth the individual quantitative measurements required by the appendix. The Agencies are proposing to add an "Applicability" paragraph to each quantitative measurement that identifies 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. In addition, the Agencies are proposing to remove the "General Calculation Guidance" paragraphs that appear in section IV of Appendix A of the 2013

final rule for each quantitative measurement. Content of these General Calculation Guidance paragraphs would instead generally be addressed in the Instructions.

i. Risk-Management Measurements

A. Risk and Position Limits and Usage

The Agencies are proposing to remove references to Stressed Value-at-Risk (Stressed VaR) in the Risk and Position Limits and Usage metric. Eliminating the requirement to report desk-level limits for Stressed VaR should reduce reporting obligations for banking entities without reducing the Agencies' ability to monitor proprietary trading.

The proposal clarifies in new "Applicability" paragraph IV.a.1.iv. that, as in the 2013 final rule, the Risk and Position Limits and Usage metric applies to all trading desks engaged in covered trading activities. For each trading desk, the proposal requires that a banking entity 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.[240] The unique identification label should allow the Agencies to efficiently obtain the descriptive information regarding the limit that is separately reported in the Risk and Position Limits Information Schedule.[241] The proposal requires a banking entity to report this descriptive information in the Risk and Position 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, to

[240] 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.

[241] Such information includes the name of the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit.

help alleviate inefficiencies associated with reporting redundant information and reduce electronic file submission sizes.

Unlike the 2013 final rule, the proposal requires a banking entity to report the limit size of both the upper bound and the lower bound of a limit if a trading desk has both an upper and lower limit. The Agencies understand that, based on a review of the collected data and discussions with banking entities, trading desks may have upper and lower limits. An upper limit means the value of risk cannot go above the limit, while a lower limit means the value of risk cannot go below the limit. This proposed amendment is intended to help identify when a trading desk has both an upper limit and a lower limit and avoid incomplete or unclear reporting under these circumstances. In addition, receipt of information about upper and lower limits, where applicable, should allow the Agencies to better evaluate the constraints that a banking entity places on the risks of a trading desk. For example, if a trading desk has both upper and lower limits but only one such limit is reported, the Agencies would not have complete information about the desk's limits or the usage of such limits, including potential limit breaches that may warrant further review.

The proposal also clarifies the 2013 final rule's requirement to separately report a trading desk's usage of its limit. As noted above, usage is the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. The value of the usage generally should be reported as of the end of the day for limits that are accounted for at the end of the day; conversely, banking entities generally should report the maximum value of the usage for limits accounted for intraday.

Question 257. Should Stressed VaR limits be removed as a reporting requirement for desks engaged in permitted market making-related activity or risk-mitigating hedging activity?

Are VaR limits without accompanying Stressed VaR limits adequate for these desks? Should another type of limit be required to replace Stressed VaR, such as expected shortfall? Should Stressed VaR limits instead be required for other types of covered trading activities besides market making-related activity or risk-mitigating hedging activity?

Question 258. Should VaR limits be removed as a reporting requirement for trading desks engaged in permitted market making-related activity or risk-mitigating hedging activity? Why or why not?

Question 259. The proposal requires a banking entity to report the limit size of both the upper bound and the lower bound of a limit if a trading desk has both an upper and lower limit. Should banking entities be required to report both the upper bound and the lower bound of a limit (if applicable) or should the requirement only apply to the upper limit? Please discuss the anticipated costs and other burdens of this new requirement and how they compare to the benefits.

B. Risk Factor Sensitivities

The proposed "Applicability" paragraph IV.a.2.iv. provides that, as in the 2013 final rule, the Risk Factor Sensitivities metric applies 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.[242]

[242] If a risk factor sensitivity 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 sensitivity during the calendar month.

The proposed unique identification label should allow the Agencies to efficiently obtain the descriptive information for the Risk Factor Sensitivity that is separately reported in the Risk Factor Sensitivities Information Schedule.[243] The proposal requires a banking entity to report this descriptive information in the Risk Factor Sensitivities Information Schedule for the entire banking entity's covered trading activity, rather than multiple times in the Risk Factor Sensitivities metric for different trading desks, to help alleviate inefficiencies associated with reporting redundant information and reduce electronic file submission sizes.

C. Value-at-Risk and Stressed Value-at-Risk

The proposal modifies the description of Stressed VaR to align its calculation with that of Value-at-Risk and removes the General Calculation Guidance. A new "Applicability" paragraph IV.a.3.iv. provides 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 Agencies believe that limiting the applicability of the Stressed VaR metric in this manner may reduce burden without impacting the ability of the Agencies to monitor for prohibited proprietary trading. In particular, the Agencies believe that applying Stressed VaR to trading desks whose covered trading activity is conducted exclusively to hedge excluded products does not provide meaningful information about whether the trading desk is engaged in proprietary trading. For example, when Stressed VaR is applied to hedges of loans held-to-maturity on a trading desk, Stressed VaR is unlikely to provide an accurate indication of the risk taken on that desk. Thus, the Agencies are providing that Stressed VaR need not be reported under these circumstances.

[243] Such information includes the name of the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit.

Question 260. Is Stressed VaR a useful metric for monitoring covered trading activity for trading desks engaged in permitted market making-related activity or underwriting activity? Why or why not? Are there other covered trading activities for which Stressed VaR is useful or not useful?

ii. Source-of-Revenue Measurements

A. Comprehensive Profit and Loss Attribution

It is unnecessary for banking entities to calculate and report volatility of comprehensive profit and loss because the measurement can be calculated from the profit and loss amounts reported under the Comprehensive Profit and Loss Attribution metric. Thus, the proposed Appendix would remove this requirement.

With respect to the profit and loss attribution to individual risk factors and other factors, the Agencies are proposing to add to the proposed Appendix a new paragraph IV.b.1.B. Under the proposal, a banking entity would be required 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 proposal requires a banking entity 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.[244] The proposal requires a banking entity to report this descriptive information in the Risk Factor Attribution Information Schedule for the entire banking entity's covered trading activity, rather than multiple times in the Comprehensive Profit

[244] 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.

and Loss Attribution metric for different trading desks, to help alleviate inefficiencies associated with reporting redundant information and reduce electronic file submission sizes.

A new "Applicability" paragraph IV.b.1.iv provides that, as in the 2013 final rule, the Comprehensive Profit and Loss Attribution metric applies to all trading desks engaged in covered trading activities.

Question 261. Appendix A of the 2013 final rule specified under Source-of-Revenue Measurements that Comprehensive Profit and Loss be divided into three categories: (i) profit and loss attributable to existing positions; (ii) profit and loss attributable to new positions; and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. Appendix A of the 2013 final rule further required that the portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. The proposed Appendix does not change these specifications. However, the Agencies' experience implementing the 2013 final rule has shown that the two statements about residual profit and loss can give rise to conflicting interpretations. The Agencies see value in monitoring any profit and loss that cannot be attributed to existing or new positions. The Agencies also see value in monitoring the profit and loss attribution to risk factors, and the Agencies' experience is that many reporters of quantitative measurements include the remainder from profit and loss attribution in the item for Residual Profit and Loss. In practice, however, profit and loss attribution is performed on existing position profit and loss, so this interpretation breaks the additivity of (i), (ii), and (iii) above. A potential resolution of this conflict would be to clarify in the Instructions for Preparing and Submitting Quantitative Measurements Information that

Residual Profit and Loss is only profit and loss that cannot be attributed to existing or new positions, and to add a separate reporting item for Unexplained Profit and Loss from Existing Positions. The Agencies are seeking comment on how beneficial for institutions and regulators this additional item would be to show and assess banking entities' profit and loss attribution analysis. How much would adding this item consume additional compliance resources of reporters?

Question 262. Appendix A of the 2013 final rule specified that profit and loss from existing positions be further attributed to (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade. The metrics reporting instructions further specified that the preponderance of profit and loss due to risk factor changes should be reported as profit and loss attributions to individual factors. The proposed Appendix and metrics instructions do not change these requirements. However, experience implementing the 2013 final rule has shown that the definition of Profit and Loss Due to Changes in Risk Factors is vague and open to multiple interpretations. The Agencies see value in monitoring the total profit and loss attribution to risk factors that banking entities use to monitor their sources of revenue, which may go beyond the preponderance of profit and loss that is reported as attributions to individual factors. Moreover, in practice profit and loss attribution is often sensitivity-based and an approximation. Banking entities also routinely calculate "hypothetical" or "clean" profit and loss, which is the full revaluation of existing positions under all risk factor changes, and is used in banking entities' risk management to compare to VaR. The Agencies are seeking comment on how best to specify the calculation for Profit and Loss Due to Risk Factor Changes. Do

commenters expect that "hypothetical" profit and loss can be derived from other items already reported? If not, what are the costs and benefits of clarifying the definition of Profit and Loss Due to Risk Factor Changes to make it align with "hypothetical" or "Clean P&L" as prescribed by market risk capital rules? Alternatively, what are the costs and benefits of clarifying the definition to be the sum of all profit and loss attributions regardless of whether they are reported individually? What would be the additional compliance costs of requiring that both "hypothetical" profit and loss and the sum of all profit and loss attributions be reported as separate items in the quantitative measurements?

iii. Positions, Transaction Volumes, and Securities Inventory Aging Measurements

A. Positions and Inventory Turnover

Paragraph IV.c.1. of Appendix A of the 2013 final rule requires banking entities to calculate and report Inventory Turnover. This metric is required to be calculated on a daily basis for 30-day, 60-day, and 90-day calculation periods. The Agencies are proposing to replace the Inventory Turnover metric with the daily data underlying that metric, rather than proposing specific calculation periods, because the Agencies may choose to use different inventory turnover calculation periods depending on the particular trading desk or covered trading activity under review. The proposal replaces Inventory Turnover with the daily Positions quantitative measurement. In conjunction with the proposed Transaction Volumes metric (discussed below), the proposed Positions metric would provide the Agencies with flexibility to calculate inventory turnover ratios over any period of time, including a single trading day.

Based on an evaluation of the information collected pursuant to the Inventory Turnover quantitative measurement, the Agencies are proposing to limit the scope of applicability of the Positions metric to trading desks that rely on § __.4(a) or § __.4(b) to conduct underwriting

activity or market making-related activity, respectively. As a result, a trading desk that does not rely on § __.4(a) or § __.4(b) would not be subject to the proposed Positions metric.[245] The proposed Positions metric would require a banking entity to report the value of securities and derivatives positions managed by an applicable trading desk. Thus, if a trading desk relies on § __.4(a) or § __.4(b) and engages in other covered trading activity, the reported Positions metric would have to reflect all of the covered trading activities conducted by the desk.[246]

The proposal provides that banking entities subject to the appendix would have 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.[247]

Finally, the proposal addresses the classification of securities and derivatives for purposes of the proposed Positions quantitative measurement. The Agencies recognize that the 2013 final

[245] For example, a trading desk that relies solely on § __.5 to conduct risk-mitigating hedging activity is not subject to the proposed Positions metric.

[246] For example, if a trading desk relies on § __.4(b) and § __.5 to conduct market making-related activity and risk-mitigating hedging activity, respectively, the reported Positions metric for the desk would be required to reflect its risk-mitigating hedging activity in addition to its market making-related activity. The Agencies note, however, that a trading desk would not be required to include trading activity conducted under §§ __.3(e), __6(c), __.6(d), or __.6(e) in the proposed Positions metric, unless the banking entity includes such activity as "covered trading activity" for the desk under the appendix. This is consistent with the proposed definition of "covered trading activity," which provides that a banking entity may include in its covered trading activity trading conducted under §§ __.3(e), __.6(c), __.6(d), or __.6(e).

[247] The Agencies note that banking entities must report the effective notional value of derivatives receivables and derivatives payables for those derivatives whose stated notional amount is leveraged. For example, if an exchange of payments associated with a $2 million notional equity swap is based on three times the return associated with the underlying equity, the effective notional amount of the equity swap would be $6 million.

rule's definition of "security" and "derivative" overlap.[248] For example, under the 2013 final rule a security-based swap is both a "security" and a "derivative."[249] The proposed Positions quantitative measurement would require banking entities to separately report the value of all securities and derivatives positions managed by a trading desk. To avoid double-counting financial instruments, the proposed Positions metric would require banking entities subject to the appendix to not include in the Positions calculation for "securities" those securities that are also "derivatives," as those terms are defined under the final rule. Instead, securities that are also derivatives under the final rule are required to be reported as "derivatives" for purposes of the proposed Positions metric.

Question 263. Should the Agencies eliminate the Inventory Turnover quantitative measurement? Why or why not? Should the Agencies replace Inventory Turnover with the proposed Positions metric in the proposed Appendix? Why or why not? Should the Agencies modify the Inventory Turnover metric rather than remove it from the proposed Appendix? If so, what modifications should the Agencies make to the Inventory Turnover metric, and why?

Question 264. What are the current benefits and costs associated with calculating the Inventory Turnover metric? To what extent would the removal of this metric reduce the costs of compliance with the proposed Appendix? Please quantify your answers, to the extent feasible.

Question 265. Is the use of the proposed Positions metric to help distinguish between permitted and prohibited trading activities effective? If not, what alternative would be more

[248] *See* 2013 final rule §§ __.2(h), (y).

[249] The term "security" is defined in the 2013 final rule by reference to section 3(a)(10) of the Securities Exchange Act of 1934 (the "Exchange Act"). *See* 2013 final rule § __.2(y). Under the Exchange Act, the term "security" means, in part, any security-based swap. *See* 15 U.S.C. 78c(a)(10). The term "security-based swap" is defined in section 3(a)(68) of the Exchange Act. *See* 15 U.S.C. 78c(a)(68). Under the 2013 final rule, the term "derivative" means, in part, any security-based swap as that term is defined in section 3(a)(68) of the Exchange Act. *See* 2013 final rule § __.2(h).

effective? What factors should be considered in order to further refine the proposed Positions metric to better distinguish prohibited proprietary trading from permitted trading activity? Does the proposed Positions metric provide any additional information of value relative to other quantitative measurements?

Question 266. Is the use of the proposed Positions metric to help determine whether an otherwise-permitted trading strategy is consistent with the requirement that such activity not result, directly or indirectly, in a material exposure by the banking entity to high-risk assets and high-risk trading strategies effective? If not, what alternative would be more effective?

Question 267. Is the proposed Positions metric substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, how should the Agencies modify this quantitative measurement, and why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?

Question 268. How beneficial is the information that the proposed Positions metric provides for evaluating underwriting activity or market making-related activity? Does the proposed Positions metric, alone or coupled with other required metrics, provide information that is useful in evaluating the customer-facing activity of a trading desk? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity? Would the proposed Positions metric be useful to evaluate other types of covered trading activity?

Question 269. How burdensome and costly would it be to calculate the proposed Positions metric at the specified calculation frequency and calculation period? What are the additional burdens or costs associated with calculating the measurement for particular trading

desks? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Question 270. How will the proposed Positions and Inventory Turnover requirements impact burdens as compared to benefits? Would the proposed changes affect a firm's confidential business information?

iv. Transaction Volumes and the Customer-Facing Trade Ratio

Paragraph IV.c.3. of Appendix A of the 2013 final 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 final 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 final 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 final 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.

While the Customer-Facing Trade Ratio may provide directionally useful information in some circumstances regarding the extent to which trades are conducted with customers, the Agencies are proposing to replace this metric with the daily Transaction Volumes quantitative measurement, set out in paragraph IV.c.2. of the proposed Appendix, for two reasons. First, the information provided by the Customer-Facing Trade Ratio metric has not been sufficiently granular to permit the Agencies to effectively assess the extent to which a trading desk's covered

trading activities are focused on servicing customer demand. Reviewing and analyzing data representing trading activity that occurs over a single trading day should be more effective. The proposed Transaction Volumes metric will provide the Agencies with flexibility to calculate customer-facing trade ratios over any period of time, including a single trading day. This will assist banking entities and the Agencies in monitoring covered trading activities. The Agencies are proposing to replace the Customer-Facing Trade Ratio with the daily data underlying that metric rather than proposing a daily calculation period for the Customer-Facing Trade Ratio because the Agencies may choose to use different customer-facing trade ratio calculation periods depending on the particular trading desk or covered trading activity under review.

Second, based on a review of the collected data, the Agencies recognize that the current Customer-Facing Trade Ratio metric does not provide meaningful information when a trading desk only conducts customer-facing trading activity. The numerator of the ratio represents transactions with counterparties that are customers, while the denominator represents transactions with counterparties that are not customers. If a trading desk only trades with customers, it will not be able to calculate this ratio because the denominator will be zero. The proposed Transaction Volumes metric enables the analysis of customer-facing activity using more meaningful and appropriate calculations.

The proposed Transaction Volumes metric measures the number and value[250] of all securities and derivatives transactions conducted by a trading desk engaged in permitted underwriting activity or market making-related activity under the 2013 final rule with four categories of counterparties: (i) customers (excluding internal transactions); (ii) non-customers

[250] For purposes of the proposed Transaction Volumes metric, value means gross market value with respect to securities. For commodity derivatives, value means the gross notional value (i.e., the current dollar market value of the quantity of the commodity underlying the derivative). For all other derivatives, value means the gross notional value.

(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. To avoid double-counting transactions, these four categories are exclusive of each other (i.e., a transaction must only be reported in one category). The proposal requires this quantitative measurement to be calculated each trading day.

As described above, the Agencies have evaluated the data collected under Appendix A of the 2013 final rule to determine whether certain quantitative measurements should be tailored to specific covered trading activities. The Customer-Facing Trade Ratio metric has primarily been used to assist in the evaluation of a trading desk's customer-facing activity, which is a relevant consideration for desks engaged in underwriting or market making-related activity under § __.4 of the 2013 final rule. Such analysis is less relevant to, for example, desks that use only the risk-mitigating hedging exemption under § __.5 of the 2013 final rule. Based on an evaluation of the information collected under the Customer-Facing Trade Ratio, the Agencies are proposing to limit the applicability of the proposed Transaction Volumes metric.

Specifically, the proposal provides that a banking entity would be required to calculate and report the proposed Transaction Volumes metric for all trading desks that rely on § __.4(a) or § __.4(b) to conduct underwriting activity or market making-related activity, respectively. This means that a trading desk that does not rely on § __.4(a) or § __.4(b) would not be subject to the proposed Transaction Volumes metric.[251] The proposed Transaction Volumes metric measures covered trading activity conducted by an applicable trading desk with specific categories of counterparties. Thus, if a trading desk relies on § __.4(a) or § __.4(b) and engages

[251] For example, a trading desk that relies solely on § __.5 to conduct risk-mitigating hedging activity would not be subject to the proposed Transaction Volumes metric.

in other covered trading activity, the reported Transaction Volumes metric would have to reflect all of the covered trading activities conducted by the desk.[252] Limiting the scope of the Transaction Volumes metric to only those trading desks engaged in market-making activity or underwriting activity may reduce reporting inefficiencies for banking entities.

This metric should provide meaningful information regarding the extent to which a trading desk facilitates demand for each category of counterparty. While the Agencies recognize that the requirement to provide additional granularity may require banking entities to expend additional compliance resources, the Agencies believe the information would enhance compliance efficiencies. In particular, by requiring transactions to be separated into these four categories, the information collected under this metric will facilitate better classification of internal trades, and thus, will assist banking entities and the Agencies in evaluating whether the covered trading activities of desks engaged in underwriting or market making-related activities are consistent with the final rule's requirements governing those activities. For example, the Agencies believe that this metric could be helpful in evaluating the extent to which a market making desk routinely stands ready to purchase and sell financial instruments related to its financial exposure, as well as the extent to which a trading desk engaged in underwriting or

[252] For example, if a trading desk relies on § __.4(b) and § __.5 to conduct market making-related activity and risk-mitigating hedging activity, respectively, the reported Transaction Volumes metric for the desk would have to reflect its risk-mitigating hedging activity in addition to its market making-related activity. The Agencies note, however, that a trading desk would not be required to include trading activity conducted under §§ __.3(e), __.6(c), __.6(d), or __.6(e) in the proposed Transaction Volumes metric, unless the banking entity includes such activity as "covered trading activity" for the desk under the proposed Appendix. The Agencies note that this is consistent with the definition of "covered trading activity," which provides that a banking entity may include in its covered trading activity trading conducted under §§ __.3(e), __.6(c), __.6(d), or __.6(e).

market making-related activity facilitates customer demand in accordance with the reasonably expected near term demand requirements under the relevant exemption.[253]

The definition of the term "customer" that is used for purposes of this quantitative measurement depends on the type of covered trading activity a desk conducts. For a trading desk engaged in market making-related activity pursuant to § __.4(b) of the 2013 final rule, the desk must construe the term "customer" in the same manner as the terms "client, customer, and counterparty" used for purposes of the market-making exemption under the 2013 final rule. For a trading desk engaged in underwriting activity pursuant to § __.4(a) of the 2013 final rule, the desk must construe the term "customer" in the same manner as the terms "client, customer, and counterparty" used for purposes of the underwriting exemption under the final rule.[254]

Similar to the proposed Positions metric, the proposed Transaction Volumes metric addresses the classification of securities and derivatives for purposes of the proposed Transaction Volumes quantitative measurement. The proposed Transaction Volumes metric requires banking entities to separately report the value and number of securities and derivatives transactions conducted by a trading desk with the four categories of counterparties described above. To avoid double-counting financial instruments, the proposed Transaction Volumes metric would require banking entities subject to the appendix to not include in the Transaction Volumes calculation for

[253] *See* 2013 final rule §§ __.4(a)(2)(ii) and __.4(b)(2)(ii).

[254] Under the proposal, the calculation guidance regarding reporting of transactions with another banking entity with trading assets and liabilities of $50 billion or more would be moved from Appendix A of the 2013 final rule into the reporting instructions. The proposed instructions for the Transaction Volumes quantitative measurement would clarify that any transaction with another banking entity with trading assets and liabilities of $50 billion or more would be included in one of the four categories noted above, including: (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.

"securities" those securities that are also "derivatives," as those terms are defined under the 2013 final rule.[255] Instead, securities that are also derivatives under the final rule would be required to be reported as "derivatives" for purposes of the proposed Transaction Volumes metric.

Question 271. Should the Agencies eliminate the Customer-Facing Trade Ratio? Why or why not? Should the Agencies replace the Customer-Facing Trade Ratio with the proposed Transaction Volumes metric in the proposed Appendix? Why or why not? Should the Agencies modify the Customer-Facing Trade Ratio rather than remove it from the proposed Appendix? If so, what modifications should the Agencies make to the Customer-Facing Trade Ratio, and why?

Question 272. What are the current benefits and costs associated with calculating the Customer-Facing Trade Ratio? To what extent would the removal of this metric reduce the costs of compliance with the proposed Appendix? Please quantify your answers, to the extent feasible.

Question 273. Would the use of the proposed Transaction Volumes metric to help distinguish between permitted and prohibited trading activities be effective? If not, what alternative would be more effective? What factors should be considered in order to further refine the proposed Transaction Volumes metric to better distinguish prohibited proprietary trading from permitted trading activity? Does the proposed Transaction Volumes metric provide any additional information of value relative to other quantitative measurements?

Question 274. Is the scope of the four categories of counterparties set forth in the proposed Transaction Volumes metric appropriate and effective? Why or why not?

Question 275. Is the proposed Transaction Volumes metric substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, how should the Agencies

[255] *See* 2013 final 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).

modify this quantitative measurement, and why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?

Question 276. How beneficial is the information that the proposed Transaction Volumes metric provides for evaluating underwriting activity or market making-related activity? Could these changes affect legitimate underwriting activity or market making-related activity? If so, how? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity? Would this metric be useful to evaluate other types of covered trading activity?

Question 277. What operational or logistical challenges might be associated with performing the calculation of the proposed Transaction Volumes metric and obtaining any necessary informational inputs? Please explain.

Question 278. How burdensome and costly would it be to calculate the proposed Transaction Volumes metric at the specified calculation frequency and calculation period? What are the additional burdens or costs associated with calculating the measurement for particular trading desks? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Question 279. Should the Agencies develop and publish more detailed instructions for how different transaction life cycle events such as amendments, novations, compressions, maturations, allocations, unwinds, terminations, option exercises, option expirations, and partial amendments affect the calculation of Transaction Volumes and the Comprehensive Profit and Loss Attribution? Please explain.

v. Securities Inventory Aging

The Agencies have evaluated whether the Inventory Aging metric is useful for all financial instruments, as well as for all covered trading activities. Based on this evaluation and a review of the data collected under this quantitative measurement, the Agencies understand that, with respect to derivatives, Inventory Aging is not easily calculated and does not provide useful risk or customer-facing activity information. Thus, the Agencies are proposing several modifications to the Inventory Aging metric.

First, the scope of the proposed Securities Inventory Aging metric, set forth in proposed paragraph IV.c.3., would be limited to a trading desk's securities positions. Under the proposal, banking entities subject to the Appendix would be required to measure and report the age profile of a trading desk's securities positions through a security-asset aging schedule and a security liability-aging schedule. 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 final rule.[256]

Second, the Agencies are proposing to limit the applicability of the Securities Inventory Aging metric to trading desks that engage in specific covered trading activities. Consistent with the proposed Positions and Transaction Volumes metrics, the proposal provides that a banking entity would be required to calculate and report the Securities Inventory Aging metric for all trading desks that rely on § __.4(a) or § __.4(b) to conduct underwriting activity or market making-related activity, respectively. This means that a trading desk that does not rely on §

[256] *See* 2013 final 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).

__.4(a) or § __.4(b) would not be subject to the proposed Securities Inventory Aging metric.[257] The proposal would require that the Securities Inventory Aging metric measure the age profile of an applicable trading desk's securities positions. Thus, if a trading desk relies on § __.4(a) or § __.4(b) and engages in other covered trading activity, the reported Securities Inventory Aging metric would have to reflect all of the covered trading activities in securities[258] conducted by the desk.[259] Narrowing the scope of the Inventory Aging metric to securities inventory and to desks that engage in market-making and underwriting activities should reduce reporting inefficiencies for banking entities without reducing the usefulness of the metric, as it has proved to be of limited utility for derivative positions or trading desks that engage in other types of covered trading activity.

Finally, the proposal would require 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

[257] For example, a trading desk that relies solely on § __.5 to conduct risk-mitigating hedging activity would not be subject to the proposed Securities Inventory Aging metric.

[258] The Agencies note that a banking entity would not be required to prepare an Inventory Aging schedule for any derivatives traded by a trading desk, including "securities" that are also "derivatives" as those terms are defined under the 2013 final rule, in the event the trading desk relies on § __.4(a) or § __.4(b) and another permitted activity exemption.

[259] For example, if a trading desk relies on § __.4(b) and § __.5 to conduct market making-related activity and risk-mitigating hedging activity, respectively, the reported Securities Inventory Aging metric for the desk would have to reflect the risk-mitigating hedging activity and market making-related activity associated with the desk's securities positions. The Agencies note, however, that a trading desk would not be required to include trading activity conducted under §§ __.3(e), __.6(c), __.6(d), or __.6(e) in the proposed Securities Inventory Aging metric, unless the banking entity includes such activity as "covered trading activity" for the desk under the proposed Appendix. The Agencies note that this is consistent with the definition of "covered trading activity," which provides that a banking entity may include in its covered trading activity trading conducted under §§ __.3(e), __.6(c), __.6(d), or __.6(e).

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.

Question 280. How beneficial is the information that the proposed Securities Inventory Aging metric provides for evaluating underwriting activity or market making-related activity? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity?

Question 281. Is inventory aging of derivatives a useful metric for monitoring covered trading activity at trading desks? Why or why not?

Question 282. Is inventory aging of futures a useful metric for monitoring covered trading activity at trading desks? Why or why not?

Question 283. Would it reduce the calculation burden on banking entities to limit the scope of the Inventory Aging metric to securities inventory and to trading desks engaged in market-making and underwriting activities? Why or why not?

Question 284. Should the Agencies require banking entities to report the Securities Inventory Aging metric according to a specific set of age ranges? Why or why not? If so, taken together, are the proposed age ranges appropriate and effective, or should the proposed Securities Inventory Aging metric require different age ranges? Do banking entities already routinely measure their securities positions using the same, or similar, age ranges?

j. Request for comment

The Agencies request comment on the costs and benefits of the proposal's revised approach under revisions to Appendix A of the 2013 final rule. In particular, the Agencies request comment on the following questions:

Question 285. Are the quantitative measurements, both as currently existing and as proposed to be modified, appropriate in general? If not, is there an alternative(s) approach that the banking entities and the Agencies could use to more effectively and efficiently identify potentially prohibited proprietary trading? If so, being as specific as possible, please describe that alternative. Should certain proposed quantitative measurements be eliminated? If so, which requirements, and why? Should additional quantitative measurements be added? If so, which measurements, and why? How would those additional measurements be described and calculated?

Question 286. What are the current annual compliance costs for banking entities to comply with the requirements in Appendix A of the 2013 final rule to calculate and report certain quantitative measurements to the Agencies? Please discuss the benefits of the proposal, including but not limited to the benefits derived from qualitative information, such as narratives and trading desk information, as compared to the costs and burdens of preparing such information. How would those annual compliance costs change if the modifications described in the proposal were adopted? Please be as specific as possible and, where feasible, provide quantitative data broken out by requirement. Would this proposal affect certain types of banking entities, such as broker-dealers and registered investment advisers, differently as compared to other banking entities in terms of annual compliance costs?

Question 287. In addition to the proposed changes to the requirement to calculate and report quantitative measurements to the Agencies, the proposed Appendix contains new qualitative requirements that are not currently required in Appendix A of the 2013 final rule, including, but not limited to, trading desk information, quantitative measurements identifying information, and a narrative statement. Please discuss the benefits and costs associated with such

proposed requirements. How would the overall burden change, in terms of both costs and benefits, as a result of the proposal, taken as a whole, as compared to the existing requirements under Appendix A? Please provide quantitative data to the extent feasible.

Question 288. Which of the proposed quantitative measurements do banking entities currently use? What are the current benefits, and would the proposed revisions result in increased compliance costs associated with calculating such quantitative measurements? Would the reporting and recordkeeping requirements in the proposed Appendix for such quantitative measurements generate any significant, additional benefits or costs? Please quantify your answers, to the extent feasible.

Question 289. How are the ongoing costs of compliance associated with the requirements of Appendix A of the 2013 final rule allocated among the different steps in the process (e.g., calculating quantitative measurements, preparing reports, delivering reports to the relevant Agencies, etc.)?

Question 290. Which requirements of Appendix A of the 2013 final rule are costliest to comply with, and what are those burdens? Please be as specific as possible. Does the proposal meaningfully reduce these aspects? Why or why not? Please quantify your answers, to the extent feasible.

Question 291. Which of the proposed quantitative measurements do banking entities currently not use? What are the potential benefits and costs of calculating these quantitative measurements and complying with the proposed reporting and recordkeeping requirements? Please quantify your answers, to the extent feasible.

Question 292. For each individual quantitative measurement that is proposed, is the description sufficiently clear? Is there an alternative that would be more appropriate or clearer?

Is the description of the quantitative measurement appropriate, or is it overly broad or narrow? If it is overly broad, what additional clarification is needed? If the description is overly narrow, how should it be modified to appropriately describe the quantitative measurement, and why? Should the Agencies provide any additional clarification to the Appendix's description of the quantitative measurement, and why?

Question 293. For each individual quantitative measurement that is proposed, is the calculation guidance provided in the proposal effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific calculation guidance necessary? If so, what level of specificity is needed to calculate the quantitative measurement? If the proposed calculation guidance is not sufficiently specific, how should the calculation guidance be modified to reach the appropriate level of specificity? If the proposed calculation guidance is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?

Question 294. Does the use of the proposed Appendix as part of the multi-faceted approach to implementing the prohibition on proprietary trading continue to be appropriate? Why or why not?

Question 295. Should a trading desk be permitted not to furnish a quantitative measurement otherwise required under the proposed Appendix if it can demonstrate that the measurement is not, as applied to that desk, calculable or useful in achieving the purposes of the Appendix with respect to the trading desk's covered trading activities? How might a banking entity make such a demonstration?

Question 296. Where a trading desk engages in more than one type of covered trading activity, such as activity conducted under the underwriting and risk-mitigating hedging

exemptions, should the quantitative measurements be calculated, reported, and recorded separately for trading activity conducted under each exemption relied on by the trading desk? What are the costs and benefits of such an approach? Please explain.

Question 297. How much time do banking entities need to develop new systems and processes, or modify existing systems and processes, to implement for banking entities that are subject to the proposed Appendix's reporting and recordkeeping requirements, and why? Does the amount of time needed to develop or modify information systems to comply with proposed Appendix, including the electronic reporting and XML Schema requirements, vary based on the size of a banking entity's trading assets and liabilities? Why or why not? What are the costs associated with such requirements?

Question 298. Under both the 2013 final rule and the proposal, banking entities that, together with their affiliates and subsidiaries, have significant trading assets and liabilities are required to calculate, maintain, and report a number of quantitative measurements. Should the Agencies eliminate this metrics reporting requirement and instead require banking entities to: (1) calculate the required quantitative measurements data, in the same form, manner, and timeframes as they would otherwise be required to under the rule; (2) maintain the required quantitative measurements data; and (3) provide the relevant Agency or Agencies with the data upon request for examination and review?

Question 299. Should the requirement to calculate and report quantitative metrics be eliminated and replaced by a different method for assisting banking entities and the Agencies in monitoring covered trading activities for compliance with section 13 of the BHC Act and the 2013 final rule? If so, what alternative approaches should the Agencies consider?

Question 300. Should some or all reported quantitative measurements be made publicly available? Why or why not? If so, which quantitative measurements should be made publicly available, and what are the benefits and costs of making such measurements publicly available? If so, how should quantitative measurements be made publicly available? Should quantitative measurements be made publicly available in the same form they are furnished to the Agencies, or should information be aggregated before it is made publicly available? If information should be aggregated, how should it be aggregated, and what are the benefits and costs associated with aggregate data being available to the public? Should quantitative measurements be made publicly available at-or-near the same time such measurements are reported to the Agencies, or should information be made publicly available on a delayed basis? If information should be made public on a delayed basis, how much time should pass before information is publicly available, and what are the benefits and costs associated with non-current metrics information being available to the public? Are there other approaches the Agencies should consider to make the quantitative measurements publicly available, and if so, what are the benefits and costs associated with each approach? What are the costs and benefits of such an approach? Please discuss and provide detailed examples of any costs or benefits identified.

Question 301. Do commenters have concerns about the potential for the inadvertent exposure of confidential business information, either as part of the reporting process or to the extent that any of the quantitative measurements (or related information) are made publicly available? If so, what are the risks involved and how might they be mitigated? Are certain quantitative measurements more likely to contain confidential information? If so, which ones and why?

IV. The Economic Impact of the Proposal under Section 13 of the BHC Act—Request for Comment

The Agencies are proposing a number of changes to the 2013 final rule that are intended to reduce the costs of compliance while continuing the rule's effectiveness in limiting prohibited activities. In what follows, the key proposed changes to the regulation that are expected to have a material impact on the costs of implementing the regulation are discussed as is the rationale for expecting a material reduction in the costs associated with compliance. The Agencies seek broad comment from the public on any and all aspects of the proposed changes to the regulation and the extent to which these changes will reduce compliance costs and improve the effectiveness of the implementing regulations. The Agencies also seek comment on whether there are any additional ways to reduce compliance costs while effectively implementing the statute. Finally, commenters are encouraged to provide the Agencies with any specific data or information that could be useful for quantifying the reductions or increases in costs associated with the proposed changes.

A key proposed change to the rule relates to the treatment of banking entities with limited trading activities, which under the 2013 final rule can face compliance costs that are disproportionately high relative to the amount of trading activity typically undertaken and the amount of risk the activities of these firms that are subject to section 13 pose to financial stability. More specifically, the Agencies are proposing to identify those banking entities with total consolidated trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1 billion. These banking entities with limited trading assets and liabilities would be

subject to a presumption of compliance under the proposal, while remaining subject to the rule's prohibitions in subparts B and C. The relevant Agency may rebut the presumption of compliance by providing written notice to the banking entity that it has determined that one or more of the banking entity's activities violates the prohibitions under subparts B or C.

The Agencies expect that this presumption would materially reduce the costs associated with complying with the rule for two reasons. First, as a result of presumed compliance, these banking entities would not be required to demonstrate compliance with many of the rule's specific requirements on an ongoing basis. As a specific example, entities with limited trading assets and liabilities would not be required to comply with the documentation requirements associated with the hedging exemption. Additionally, these entities would not be required to specify and maintain trading risk limits to comply with the rule's market making exemption. As a result, this proposed change is expected to meaningfully reduce the costs associated with rule compliance for smaller banking entities that do not engage in the types of trading the rule seeks to address.

Second, these banking entities would not be subject to the express requirement to maintain a compliance program pursuant to § __.20 under the proposal to demonstrate compliance with the rule. The presumption would be rebuttable, so firms may need to maintain a certain level of resources to respond to supervisory requests for information in the event that the Agencies exercise their authority to rebut the presumption of compliance for any activity that they determine to violate prohibitions under subparts B and C. The amount of resources required for such purposes is expected to be significantly smaller than the amount of resources that would be required to maintain and execute an ongoing compliance program.

Question 302. Do commenters agree that the proposed establishment of a presumption of compliance for certain banking entities would meaningfully reduce the compliance costs associated with the rule relative to the requirements of the 2013 final rule?

Question 303. Have commenters quantified the extent to which such costs are reduced? If so, could this information be provided to the Agencies during the notice and comment period?

Question 304. Do commenters believe that any aspect of the proposed establishment of a presumption of compliance would increase the costs associated with rule compliance? If so, which aspects of the presumption would raise costs, why, and to what extent? How could these compliance costs be addressed or reduced?

Question 305. What costs do commenters anticipate a banking entity subject to presumed compliance would bear to respond to possible questions from the Agencies about the banking entity's compliance with the statute and the sections of the regulation that remain applicable to it? In general, how and to what extent does a shifting of the burden from banking entity to Agencies affect compliance costs? What steps could the Agencies take to appropriately reduce compliance burdens in this regard – especially for banking entities that engage in less trading activity?

The Agencies are also proposing two changes related to the 2013 final rule's definition of "trading account" that are expected to simplify the analysis associated with determining whether or not a banking entity's purchase or sale of a financial instrument is for the trading account, and thereby are expected to reduce the costs associated with complying with the rule. Specifically, the Agencies are proposing to add an accounting prong to the definition of "trading account" and to remove the short-term intent prong and the 60-day rebuttable presumption. The Agencies

expect that the removal of the short-term intent prong will substantially reduce the costs of complying with the rule.

In the case of the short-term intent prong and the 60-day rebuttable presumption, the Agencies' experience with implementing the 2013 final rule strongly suggests that application of the short-term intent prong resulted in a variety of analyses to determine if a financial position was taken with the "intent" of generating short-term profits, or benefitting from short-term price movements. Assessing intent is qualitative and can be subject to significant interpretation. Accordingly, experience suggests that banking entities engage in a number of lengthy analyses to determine whether or not a financial position needs to be included in the trading account, and that these analyses may not always result in a clear indication.

In the case of the 60-day rebuttable presumption, the Agencies' experience suggests that the 60-day rebuttable presumption may be an overly inclusive instrument to determine whether a financial instrument is in the trading account. Many financial positions are scoped into the trading account automatically due to the 60-day presumption, and banking entities routinely conduct detailed and lengthy assessments of transactions to document that these positions should not be included in the trading account. However, experience indicates that there is no clear set of analyses that may be conducted to rebut the presumption and a clear standard for successfully rebutting the presumption has been difficult to establish in practice. Accordingly, the Agencies expect that removing the 60-day rebuttable presumption would materially reduce the costs associated with complying with the rule and determining whether a financial instrument is in the trading account.

The Agencies expect that this proposal would reduce the costs of rule compliance since banking entities are already familiar with accounting standards and use these standards to

classify financial instruments on a regular basis to satisfy reporting and related requirements. The Agencies would expect that no new compliance costs would result from using accounting concepts that are already familiar to banking entities for purposes of identifying activity in the trading account.

The Agencies are also proposing to include a presumption of compliance for trading desks, the positions of which are included in the trading account due to the accounting prong, so long as the profit and loss of the desk does not exceed a certain threshold. Specifically, the trading activity conducted by a trading desk is presumed to be in compliance with the prohibition on proprietary trading if (i) none of the financial instruments of the desk are included in the trading account pursuant to the market risk capital prong, (ii) none of the financial instruments of the desk are booked in a dealer, swap dealer, or security-based swap dealer, and (iii) the sum over the preceding 90-calendar-day period of the absolute values of the daily net realized and unrealized gains and losses of the desk's portfolio of financial instruments does not exceed $25 million. Banking entities and supervisors will only need to consider cases in which the size of trading activity exceeds the $25 million threshold for these desks. Moreover, this analysis draws on profit and loss metrics that banking entities already regularly maintain and consequently would not be expected to contribute to any increased regulatory costs.

The Agencies recognize that implementing the new definition of "trading account" and the presumption of compliance would result in some amount of compliance costs. However, the Agencies expect that the compliance costs associated with this new definition and presumption of compliance would be significantly less than the compliance costs of either the short-term intent prong or the 60-day rebuttable presumption. As noted above, the new trading account definition ties to accounting concepts that are already familiar to banking entities. Similarly, the

new presumption of compliance ties to profit and loss metrics that banking entities already maintain. As such, the Agencies expect that the new trading account definition and the presumption of compliance would materially reduce the costs of rule compliance relative to the 2013 final rule's existing requirements.

Question 306. Do commenters believe that the proposed changes to the trading account definition would materially reduce costs associated with rule compliance relative to the final rule? Why or why not?

Question 307. Do commenters have any specific data or information that could be used to quantify the extent to which such costs would be reduced under the proposal?

Question 308. Do commenters believe that any aspect of the proposed changes to the trading account definition increase the costs associated with rule compliance? If so, which aspects of the proposed changes raise costs, why, and to what extent?

As described in section 1(d)(3) of this Supplementary Information, the Agencies are proposing a specific alternative to allow banking entities to define trading desks in a manner consistent with their own internal business unit organization. The Agencies request comment regarding the relative costs and benefits of this possible alternative.

Question 309. Do commenters believe that the relative benefits of the definition of "trading desk" in the current 2013 final rule outweigh any potential cost reductions for banking entities under the alternative?

Question 310. Do commenters have any specific data or information that could be used to quantify the extent to which such costs would be reduced?

Question 311. Do commenters think that any aspect of the proposed changes to the trading desk definition increases the regulatory burden associated with rule compliance? If so which aspects of the proposed changes raise the regulatory burden, why, and to what extent?

A key statutory exemption from the prohibition on proprietary trading is the exemption for underwriting. The 2013 final rule contains a number of complex requirements that are intended to ensure that banking entities comply with the underwriting exemption and that proprietary trading activity is not conducted under the guise of underwriting. Since adoption of the 2013 final rule, banking entities have communicated to the Agencies that complying with all of the 2013 final rule's underwriting requirements can be difficult and costly relative to the underlying activities. In particular, banking entities have communicated that they believe they must engage in a number of complex and intensive analyses to gain comfort that their underwriting activities meets all of the 2013 final rule's requirements. Moreover, banking entities have communicated that they find the requirements of the 2013 final rule ambiguous to apply in practice and do not provide sufficiently bright-line conditions under which trading activity can clearly be classified as permissible underwriting.

The Agencies are proposing to establish the articulation and use of internal risk limits as a key mechanism for conducting trading activity in accordance with the underwriting exemption. These risk limits would be established by the banking entity at the trading desk level and designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties. The proposed risk limits would not be required to be based on any specific or mandated analysis. Rather, a banking entity would be permitted to establish the risk limits according to its own internal analyses and processes around conducting its underwriting activities. Banking entities would be expected to maintain internal policies and procedures for

setting and reviewing desk-level risk limits in a manner consistent with the applicable statutory factor. A banking entity's risk limits would be subject to general supervisory review and oversight, but the limit-setting process would not be required to adhere to specific, pre-defined requirements beyond adherence to the banking entity's own ongoing and internal assessment of the reasonably expected near-term demands of clients, customers, or counterparties. So long as a banking entity maintains an ongoing and consistent process for setting such limits in accordance with the proposal, then the Agencies anticipate that trading activity conducted within the limits would generally be presumed to be underwriting.

The Agencies expect that the proposed reliance on risk limits to satisfy the underwriting exemption will materially reduce the costs of complying with the final rule's underwriting exemption. In particular, the limit-setting process is intended to leverage a banking entity's existing internal risk management and capital allocation processes, and would not be required to conform to any specific or pre-defined requirements other than being set in accordance with RENTD. The Agencies expect that reliance on risk limits would therefore align with the firm's internal policies and procedures for conducting underwriting in a manner consistent with the requirements of section 13 of the BHC Act. Accordingly, the Agencies expect that this proposed approach would generally be more efficient and less costly than the practices required by the 2013 final rule as they rely to a greater extent on the banking entity's own internal policies, procedures, and processes.

Question 312. The Agencies are also proposing to further tailor the requirements for banking entities with moderate trading activities and liabilities. In particular, the compliance program requirements that are part of the underwriting exemption would not apply to these firms. Do commenters believe that the proposed changes related to the use of risk limits in

satisfying the underwriting exemption would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 313. Do commenters believe there are any benefits of the approach in the 2013 final rule that would be forgone with the proposed changes related to the use of risk limits in satisfying the underwriting exemption?

Question 314. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 315. Do commenters believe that any aspect of the proposed changes related to the use of risk limits in satisfying the underwriting exemption increases the costs associated with rule compliance? If so which aspects of the proposed changes raise compliance costs, why, and to what extent?

Question 316. Do commenters believe that the proposed changes related to the reduced compliance program requirements for banking entities with moderate trading assets and liabilities to satisfy the underwriting exemption would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 317. Do commenters believe there are any benefits to the approach in the 2013 final rule that would be forgone with the proposed changes related to the compliance requirements in satisfying the underwriting exemption?

Question 318. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 319. Do commenters think that any aspect of the proposed changes related to the use of compliance program requirements in satisfying the underwriting exemption would

increase the costs associated with rule compliance? If so, which aspects of the proposed changes would increase compliance costs, why, and to what extent?

Another key statutory exemption from the prohibition on proprietary trading is the exemption for market making. The 2013 final rule contains a number of complex requirements that are intended to ensure that proprietary trading activity is not conducted under the guise of market making. Since adoption of the 2013 final rule, banking entities have communicated that complying with all of the 2013 final rule's market making requirements can be difficult and costly. In particular, banking entities have communicated that they believe they must engage in a number of complex and intensive analyses to gain comfort that their bona fide market making activity meets all of the 2013 final rule's requirements. Moreover, banking entities have communicated that they view the requirements of the 2013 final rule as ambiguous and not providing sufficiently bright-line conditions under which trading activity can clearly be classified as permissible market making.

The Agencies are proposing to establish the articulation and use of internal risk limits as the key mechanism for conducting trading activity in accordance with the rule's exemption for market making-related activities. These risk limits would be established by the banking entity at the trading desk level and be designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties. Banking entities would be expected to maintain internal policies and procedures for setting and reviewing desk-level risk limits in a manner consistent with the applicable statutory factor. Moreover, the proposed risk limits would not be required to be based on any specific or mandated analysis. Rather, a banking entity would be permitted to establish the risk limits according to its own internal analyses and processes around conducting its market making activities as market making is defined by the applicable statutory factor. A

banking entity's risk limits would be subject to supervisory review and oversight, but the limit-setting process would not be required to adhere to any specific, pre-defined requirements beyond adherence to the banking entity's own ongoing and internal assessment of the reasonably expected near-term demand of clients, customers, or counterparties. So long as a banking entity maintains an ongoing and consistent process for setting such limits in accordance with the proposal, then the Agencies anticipate that trading activity conducted within the limits would generally be presumed to be market making.

The Agencies expect that the proposed reliance on internal risk limits to satisfy the statutory requirement that market making-related activities be designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties would materially reduce the costs of complying with the 2013 final rule's market making exemption. In particular, the limit-setting process would be intended to leverage a banking entity's existing internal risk management and capital allocation processes and would not be required to conform to specific or pre-defined requirements. The Agencies expect that reliance on risk limits would therefore align with the firm's internal policies and procedures for conducting market making in a manner consistent with the requirements of section 13 of the BHC Act. Accordingly, the agencies expect that this proposed approach would generally be more efficient and less costly than the practices required by the 2013 final rule as they rely to a greater extent on the banking entity's own internal policies, procedures, and processes.

The Agencies are also proposing to further tailor the requirements for banking entities with moderate trading activities and liabilities. In particular, the compliance program requirements that are part of the market making exemption would not apply to these firms.

Question 320. Do commenters believe that the proposed changes related to the use of risk limits in satisfying the market making exemption would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 321. Do commenters believe there are any benefits of the approach in the 2013 final rule that would be forgone with the proposed changes related to the use of risk limits in satisfying the market making exemption?

Question 322. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 323. Do commenters believe that any aspect of the proposed changes related to the use of risk limits in satisfying the market making exemption increases the costs associated with rule compliance? If so, which aspects of the proposed changes raise compliance costs, why, and to what extent?

Question 324. Do commenters agree that the proposed changes related to the reduced compliance program requirements for banking entities with moderate trading assets and liabilities to satisfy the market making exemption materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 325. Do commenters believe there are any benefits of the approach in the 2013 final rule that would be forgone with the proposed changes related to the compliance requirements in satisfying the market making exemption?

Question 326. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 327. Do commenters believe that any aspect of the proposed changes related to the use of risk limits in satisfying the market making exemption increases the costs associated

with rule compliance? If so, which aspects of the proposed changes raise compliance costs, why, and to what extent?

The agencies are proposing a number of changes to the requirements of the 2013 final rule's exemption for risk-mitigating hedging activities that are expected to reduce the costs associated with complying with the final rule's requirements.

First, for banking entities with significant trading assets and liabilities, the 2013 final rule's requirement in the risk mitigating hedging exemption to conduct a correlation analysis would be removed. Since adoption of the 2013 final rule, banking entities have communicated that this requirement has in practice been unclear and often not useful in determining whether or not a given transaction provides meaningful hedging benefits. The Agencies expect that the proposed removal of this requirement from the final rule would materially reduce the costs of rule compliance since larger banking entities would not be required to conduct a specific analysis that is currently required under the 2013 final rule.

Second, for these banking entities with significant trading assets and liabilities, the Agencies are proposing that the requirement that the hedging transaction "demonstrably reduce (or otherwise significantly mitigate)" risk be removed. Banking entities have communicated that these requirements can be unclear and these banking entities must often engage in a number of complex and time-intensive analyses to assess whether these standards have been met. Moreover, the above hedging standards have not aligned well with banking entities' internal processes for assessing the economic value of a hedging transaction. Accordingly, the Agencies expect that eliminating these requirements would materially reduce the costs associated with complying with the requirements of the rule's hedging exemption.

Third, for banking entities with moderate trading assets and liabilities, the Agencies are proposing to remove all of the hedging requirements under the 2013 final rule except for the requirement that the transaction be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks in connection with and related to one or more identified positions and that the hedging activity be recalibrated to maintain compliance with the rule. The Agencies expect this proposed change to materially reduce the costs of rule compliance since no additional documentation or prescribed analyses would be required beyond a banking entity's already existing practices and whatever analyses are required to ascertain that the remaining factors are satisfied, consistent with the statute. In light of Agency experience with the hedging requirements of the 2013 final rule, the Agencies expect that this proposed change would result in a material reduction in the costs associated with complying with the rule's hedging requirements.

Question 328. Do commenters believe that the proposed changes that streamline the hedging requirements of the rule materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 329. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 330. Do commenters believe that any aspect of the proposed changes to streamline the hedging requirements of the rule increases the costs associated with rule compliance? If so, which aspects of the proposed changes raise costs, why, and to what extent?

The Agencies are proposing to eliminate a number of requirements related to the foreign trading exemption. These proposed changes are intended to respond to concerns raised by FBOs

subject to the 2013 final rule that they find its foreign trading exemption to be difficult to comply with in practice.

The Agencies are proposing to modify the requirement of this exemption that personnel of the banking entity who arrange, negotiate, or execute a purchase or sale must be outside the United States and to eliminate the requirements that: (1) no financing be provided by a U.S. affiliate or branch, and (2) a transaction with a U.S. counterparty must be executed through an unaffiliated intermediary and an anonymous exchange.

The Agencies expect that the modification and removal of these requirements would materially reduce the compliance costs associated with the foreign trading exemption.
In addition, banking entities have communicated that the requirement that any transaction with a U.S. counterparty be executed without involvement of U.S. personnel of the counterparty or through an unaffiliated intermediary and an anonymous exchange may in some cases significantly reduce the range of counterparties with which transactions can be conducted as well as increase the cost of those transactions, including with respect to counterparties seeking to do business with a foreign banking entity in foreign jurisdictions. Therefore, the Agencies also expect that removing this requirement would materially reduce the costs associated with rule compliance.

Question 331. Do commenters believe that the proposed changes to modify and eliminate certain requirements from the foreign trading exemption would materially reduce the regulatory burden associated with rule compliance relative to the 2013 final rule?

Question 332. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 333. Do commenters believe that any aspect of the proposed changes to eliminate certain requirements from the foreign trading exemption increases the costs associated with rule compliance? If so which aspects of the proposed changes raise costs, why, and to what extent?

The Agencies are proposing to make a number of changes to the metrics reporting requirements that are intended to improve the effectiveness of the metrics. On the whole, these changes are also expected to reduce the compliance costs associated with the metrics reporting requirements. In particular, the Agencies are proposing to add qualitative information schedules that would improve the Agencies' ability to understand and analyze the quantitative measurements. The Agencies are also proposing to remove certain metrics, such as inventory aging for derivatives and stressed value-at-risk for risk mitigating hedging desks, that based on experience with implementing the 2013 final rule, are not effective for identifying whether a banking entity's trading activity is consistent with the requirements of the 2013 final rule. In addition, the Agencies are proposing to switch to a standard XML format for the metrics data file. The Agencies expect this to improve consistency and data quality by both clarifying the format specification and making it possible to check the validity of data files against a published template using generally available software. Finally, the Agencies are proposing to make a number of changes to the technical calculation guidance for a number of metrics that should make the required calculations clearer and less complicated.

The Agencies are also proposing to provide certain banking entities that must report metrics with additional time to report metrics. Specifically, the firms with $50 billion in trading assets and liabilities would have 20 days instead of 10 days to report metrics to the Agencies. This change is expected to reduce compliance costs as the additional time would allow the

required workflow to be conducted under less time pressure and with greater efficiency and accuracy.

Question 334. Do commenters believe that the proposed changes to the metrics reporting requirements would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 335. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 336. Do commenters believe that any aspect of the proposed changes to the metrics reporting requirements would increase the costs associated with rule compliance? If so, which aspects of the proposed changes increase costs, why, and to what extent?

The Agencies are proposing to modify certain requirements regarding the ability of banking entities to engage in underwriting and market-making of third-party covered funds that would remove some of the restrictions on activities with respect to covered fund interests. The Agencies expect that this proposed change would reduce the costs of compliance with the 2013 final rule's requirements. In particular, the 2013 final rule places a number of restrictions on underwriting and market-making of covered fund interests that banking entities have indicated are costly to comply with and view as unduly limiting activity that is otherwise consistent with bona fide underwriting and market-making activity that would be allowed with respect to any other type of financial instrument, consistent with the statutory factors defining these activities.

Question 337. Do commenters believe that the proposed changes to certain restrictions on covered fund related activities would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 338. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 339. Do commenters believe that any aspect of the proposed changes to certain restrictions on covered fund related activities would increase the costs associated with rule compliance? If so, which aspects of the proposed changes would raise costs, why, and to what extent?

The Agencies are proposing several changes to the required compliance program requirements that are expected to materially reduce the costs associated with complying with the rule's requirements. Specifically, banking entities with significant trading assets and liabilities would only need to maintain a standard six-pillar compliance program (i.e., written policies and procedures, internal controls, management framework, independent testing, training, and records) and would not be required to maintain most aspects of the enhanced compliance program that is required by the 2013 final rule for such large banking entities. Agency experience with implementing the 2013 final rule indicates that the operation of the 2013 final rule's enhanced compliance program can be costly and unrelated to other compliance efforts that these banking entities routinely conduct. Accordingly, eliminating this requirement would be expected to materially reduce the costs of complying with the rule.

In the case of banking entities with moderate trading assets and liabilities, these banking entities would only be required to maintain the simplified compliance program that is described in the 2013 final rule. Namely, these entities would only be required to update their existing compliance policies and procedures and would not be required to maintain a standard six-pillar compliance program as is required under the 2013 final rule. Since the simplified compliance program is much less intensive and costly to implement than the standard six-pillar compliance

program, the Agencies expect that this proposed change would materially reduce the costs associated with complying with the 2013 final rule's compliance program requirements for these smaller banking entities.

Question 340. Do commenters agree that the proposed changes to the compliance program requirements would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Question 341. Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Question 342. Do commenters believe that any aspect of the proposed changes to the compliance program requirements increases the costs associated with rule compliance? If so which aspects of the proposed changes would raise costs, why, and to what extent?

The above discussion outlines the Agencies' views on the most significant sources of cost reduction that arise from this proposal. At the same time, the Agencies are aware that there may be other aspects of the proposal that commenters view as either decreasing or increasing costs associated with the 2013 final rule. Accordingly, the Agencies seek broad comment on any other aspects of the proposal that would either increase or decrease the costs associated with the rule. Commenters are encouraged to be specific and to provide any data or information that would help demonstrate their views as well as potential ways to mitigate costs.

V. Administrative Law Matters

A. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338, 1471, 12 U.S.C. 4809), requires the 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 proposal in a simple and straightforward manner, and invite your comments on how to make

this proposal easier to understand.

For example:

• *Have the agencies organized the material to suit your needs? If not, how could this material be better organized?*

• *Are the requirements in the proposal clearly stated? If not, how could the proposal be more clearly stated?*

• *Does the proposal contain language or jargon that is not clear? If so, which language requires clarification?*

• *Would a different format (*e.g.*, grouping and order of sections, use of headings, paragraphing) make the proposal easier to understand? If so, what changes to the format would make the proposal easier to understand?*

• *Would more, but shorter, sections be better? If so, which sections should be changed?*

• *What else could the agencies do to make the regulation easier to understand?*

B. Paperwork Reduction Act Analysis Request for Comment on Proposed Information Collection

Certain provisions of the proposed 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 proposed rule and determined that the proposed rule revises certain reporting and recordkeeping requirements that have been previously cleared under various OMB control numbers. The agencies are proposing to extend for three years, with revision, these information collections. The information collection requirements contained in this joint notice of proposed rulemaking

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 proposed rule under the authority delegated to the Board by OMB. The Board will submit information collection burden estimates to OMB and the submission will include burden for Federal Reserve-supervised institutions, as well as burden for OCC-, FDIC-, SEC-, and CFTC-supervised institutions under a holding company. The OCC and the FDIC will take burden for banking entities that are not under a holding company.

Comments are invited on:

a. Whether the collections of information are necessary for the proper performance of the agencies' functions, including whether the information has practical utility;

b. The accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

c. Ways to enhance the quality, utility, and clarity of the information to be collected;

d. Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

e. Estimates of capital or startup costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the ADDRESSES section. A copy of the comments may also be submitted to the OMB desk officer for the Agencies by mail to U.S. Office of Management and

Budget, 725 17th Street NW, #10235, Washington, DC 20503, by facsimile to 202-395-5806, or by e-mail to oira_submission@omb.eop.gov, Attention, Commission and Federal Banking Agency Desk Officer.

Abstract

Section 619 of the Dodd-Frank Act added section 13 to the BHC Act, which 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. Each agency issued a common final rule implementing section 619 that became effective on April 1, 2014. Section __.20(d) and Appendix A of the final rule require certain of the largest banking entities to report to the appropriate agency certain quantitative measurements.

Current Actions

The proposed rule contains requirements subject to the PRA and the changes relative to the current final rule are discussed herein. The new and modified reporting requirements are found in sections __.3(c), __.3(g), __.4(a)(8)(iii), __.4(a)(8)(iv), __.4(b)(6)(iii), __.4(b)(6)(iv), __.20(d), and __.20(g)(3). The modified recordkeeping requirements are found in sections __.5(c), __.20(b), __.20(c), __.20 (d), __.20(e), and __.20(f)(2). The modified information collection requirements[260] would implement section 619 of the Dodd-Frank Act. The respondents are for-profit financial institutions, including small businesses. A covered entity

[260] In an effort to provide transparency, the total cumulative burden for each agency is shown. In addition to the changes resulting from the proposed rule, the agencies are also applying a conforming methodology for calculating the burden estimates in order to be consistent across the agencies.

must retain these records for a period that is no less than 5 years in a form that allows it to promptly produce such records to the relevant Agency on request.

Reporting Requirements

Section __.3(c) would require that under the revised short-term prong, certain banking entities to report to the appropriate agency when a trading desk exceeds $25 million in absolute values of the daily net realized and unrealized gain and loss over the preceding 90 day period if the banking entity chooses to perform this calculation for a trading desk in order to meet the presumption of compliance. The agencies estimate that the new reporting requirement would be collected twice a year with an average hour per response of 1 hour.

Section __.3(g) would require that notice and response procedures be followed under the reservation of authority provision. The agencies estimate that the new reporting requirement would be collected once a year with an average hours per response of 2 hours.

Sections __.4(a)(8)(iii) and __.4(b)(6)(iii) would require that banking entities report to the appropriate agency when their internal risk limits under the RENTD framework for market-making and underwriting have been exceeded. These reporting requirements would be included in the section __.20(d) reporting requirements.

Section __.20(d) would be modified by extending the reporting period for banking entities with $50 billion or more in trading assets and liabilities from within 10 days of the end of each calendar month to 20 days of the end of each calendar month. The agencies estimate that the current average hours per response would decrease by 14 hours (decrease 40 hours for initial set-up).

Sections __.3(c)(2), __.3(g)(2), __.4(a)(8)(iv), __.4(b)(6)(iv), and __.20(g)(3) would set forth proposed notice and response procedures that an agency would follow when exercising its

reservation of authority to modify what is in or out of the trading account. These reporting requirements would be included in the section __.3(c) reporting requirements for section __.3(c)(2); the section __.3(g) reporting requirements for section __.3(g)(2); and the section __.20(d) reporting requirements for section __.4(a)(8)(iv), __.4(b)(6)(iv), and __.20(g)(3).

Recordkeeping Requirements

Section __.5(c) would be 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 would decrease by 20 hours (decrease 10 hours for initial set-up).

Section __.20(b) would be 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 would not change.

Section __.20(c) would be modified by limiting the CEO attestation requirement to a banking entity that has significant trading assets and liabilities or moderate trading assets and liabilities. The agencies estimate that the current average hours per response would decrease by 1,100 hours (decrease 3,300 hours for initial set-up).

Section __.20(d) would be modified by extending the time period for reporting for banking entities with $50 billion or more in trading assets and liabilities from within 10 days of the end of each calendar month to 20 days of the end of each calendar month. The agencies estimate that the current average hours per response would decrease by 3 hours.

Section __.20(e) would be modified by limiting the requirement to banking entities with significant trading assets and liabilities. The agencies estimate that the current average hours per response would not change.

Section __.20(f)(2) would be modified by limiting the requirement to banking entities with moderate trading assets and liabilities. The agencies estimate that the current average hours per response would not change.

The Instructions for Preparing and Submitting Quantitative Measurement Information, Technical Specifications Guidance, and XML Schema are available for review 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;
- SEC: https://www.sec.gov/structureddata/dera_taxonomies.

Proposed Revision, With Extension, of the Following Information Collections
Estimated average hours per response:

Reporting

Section __.3(c) – 1 hour for an average of 2 times per year.

Section __.3(g) – 2 hours.

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) for quarterly and monthly filers.

Recordkeeping

Section __.3(e)(3) – 1 hour (Initial set-up 3 hours).

Section __.4(b)(3)(i)(A) – 2 hours for quarterly filers.

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) (entities with $50 billion or more in trading assets and liabilities) – 13 hours.

Section __.20(d) (entities with at least $10 billion and less than $50 billion in trading assets and liabilities) – 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, monthly, quarterly, and on occasion.

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: 38.

Proposed revisions estimated annual burden: -469 hours.

Estimated annual burden hours: 20,712 hours (1,784 hour for initial set-up and 18,928 hours for ongoing).

Board

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements Associated with Regulation VV.

Frequency: Annual, monthly, quarterly, and on occasion.

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 Bank Holding Company Act (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: 41.

Proposed revisions estimated annual burden: -51,219 hours.

Estimated annual burden hours: 45,558 hours (1,784 hour for initial set-up and 43,774 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, monthly, quarterly, and on occasion.

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: 53.

Proposed revisions estimated annual burden: -10,305 hours.

Estimated annual burden hours: 10,632 hours (1,784 hours for initial set-up and 8,848 hours for ongoing).

C. **Initial Regulatory Flexibility Act Analysis**

The Regulatory Flexibility Act ("RFA")[261] requires an agency to either provide an initial regulatory flexibility analysis with a proposal or certify that the proposal will not have a

[261] 5 U.S.C. 601 *et seq.*

significant economic impact on a substantial number of small entities. The U.S. Small Business Administration ("SBA") establishes size standards that define which entities are small businesses for purposes of the RFA.[262] 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.[263] The Agencies are separately publishing initial regulatory flexibility analyses for the proposals as set forth in this NPR.

Board

The Board has considered the potential impact of the proposed rule on small entities in accordance with the RFA. Based on the Board's analysis, and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial of number of small entities. Nevertheless, the Board is publishing and inviting comment on this initial regulatory flexibility analysis. A final regulatory flexibility analysis will be conducted after comments received during the public comment period have been considered.

The Board welcomes comment on all aspects of its analysis. In particular, the Board requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

1. Reasons for the Proposal

As discussed in the **Supplementary Information**, the Agencies are proposing to revise the 2013 final rule in order to provide clarity to banking entities about what activities are

[262] 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*.

[263] *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).

prohibited, reduce compliance costs, and improve the ability of the Agencies to make supervisory assessments regarding compliance relative to the 2013 final rule. To minimize the costs associated with the 2013 final rule in a manner consistent with section 13 of the BHC Act, the Agencies are proposing to simplify and tailor the rule in a manner that would substantially reduce compliance costs for all banking entities and, in particular, small banking entities and banking entities without significant trading operations.

2. Statement of Objectives and Legal Basis

As discussed above, the Agencies' objective in proposing this rule is to reduce the compliance costs for all banking entities and, in particular, to tailor the rule based on the size of the banking entity and the complexity of its trading operations. The Agencies are explicitly authorized under section 13(b)(2) of the BHC Act to adopt rules implementing section 13.[264]

3. Description of Small Entities to Which the Regulation Applies

The Board's proposal would apply to state-chartered banks that are members of the Federal Reserve System (state member banks), bank holding companies, foreign banking organizations, and nonbank financial companies supervised by the Board (collectively, "Board-regulated banking entities"). However, the Board notes that the Economic Growth, Regulatory Relief, and Consumer Protection Act,[265] which was enacted on May 24, 2018, amends section 13 of the BHC Act by narrowing the definition of banking entity. Accordingly, no small top-tier bank holding company would meet the threshold criteria for application of the provisions provided in this proposal and, therefore, the proposed amendments to the 2013 final rule would not have a significant economic impact on a substantial number of small entities.

[264] 12 U.S.C. 1851(b)(2).

[265] Pub. L. 115-174, 132 Stat. 1296-1368 (2018).

4. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The proposal would reduce reporting, recordkeeping, and other compliance requirements for small entities. First, banking entities with consolidated gross trading assets and liabilities below $10 billion would be subject to reduced requirements and a tailored approach in light of their significantly smaller and less complex trading activities. Second, in order to further reduce compliance requirements for small and mid-sized banking entities, the Agencies have proposed a rebuttable presumption of compliance for firms that do not have consolidated gross trading assets and liabilities in excess of $1 billion. All Board-regulated banking entities that meet the SBA definition of small entities (i.e., those with consolidated assets of $550 million or less) have consolidated gross trading assets and liabilities below $1 billion and thus would be subject to the presumption of compliance.

As discussed in the **Supplementary Information**, the Agencies expect that this rebuttable presumption of compliance would materially reduce the costs associated with complying with the rule. As a result of this presumed compliance, these banking entities would not be required to comply with many of the rule's specific requirements to demonstrate compliance, such as the documentation requirements associated with the hedging exemption. Additionally, these entities would not be required to specify and maintain trading risk limits to comply with the rule's market making exemption. Accordingly, these smaller entities would generally not be required to devote resources to demonstrate compliance with any of the rule's requirements.

Without this presumption of compliance, these banking entities would generally be required to comply with the rule's applicable substantive requirements to demonstrate compliance with the rule. As a result, this proposed change is expected to meaningfully reduce the costs associated with rule compliance for small banking entities. The presumption would be

rebuttable, so a banking entity would need to maintain a certain level of resources to respond to supervisory requests for information in the event that the presumption of compliance is rebutted; however, the Agencies would not expect these banking entities to maintain anything other than what they would normally maintain in the ordinary course. The amount of resources required for such purposes is expected to be significantly smaller than the amount of resources that would be required to maintain and execute ongoing compliance with the 2013 final rule's requirements.

5. Identification of Duplicative, Overlapping, or Conflicting Federal Regulations

The Board has not identified any federal statutes or regulations that would duplicate, overlap, or conflict with the proposed revisions.

6. Discussion of Significant Alternatives

The Board believes the proposed amendments to the 2013 final rule will not have a significant economic impact on small banking entities supervised by the Board and therefore believes that there are no significant alternatives to the proposal that would reduce the economic impact on small banking entities supervised by the Board.

OCC

The RFA, requires an agency, in connection with a proposed rule, to prepare an Initial Regulatory Flexibility Analysis describing the impact of the proposed rule on small entities, or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities. For purposes of the RFA, the SBA defines small entities as those with $550 million or less in assets for commercial banks and savings institutions, and $38.5 million or less in assets for trust companies.

The OCC currently supervises approximately 886 small entities.[266]

Pursuant to section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (May 24, 2018), OCC-supervised institutions with total consolidated assets of $10 billion or less 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, and they are not controlled by a company that has total consolidated assets over $10 billion or total trading assets and trading liabilities that exceed 5 percent of total consolidated assets. The proposal may impact two OCC-supervised small entities, which is not a substantial number. Therefore, the OCC certifies that the proposal would not have a significant economic impact on a substantial number of small entities.

FDIC

a. Regulatory Flexibility Act

The RFA, generally requires an agency, in connection with a proposed rule, to prepare and make available for public comment an initial regulatory flexibility analysis that describes the impact of a proposed rule on small entities.[267] 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

[266] 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 we should classify an OCC-supervised institution as a small entity. The OCC used December 31, 2017, 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*.

[267] 5 U.S.C. 601 et seq.

organizations with total assets of less than or equal to $550 million.[268] As discussed further below, the FDIC certifies that this proposed rule would not have a significant economic impact on a substantial number of FDIC-supervised small entities.

b. Reasons for and Policy Objectives of the Proposed Rule

The Agencies are issuing this proposal to amend the 2013 final rule in order to provide banking entities with additional certainty and reduce compliance obligations and costs where possible. The Agencies acknowledge that many small banking entities have found certain aspects of the 2013 final rule to be complex or difficult to apply in practice.[269] The proposed rule amends existing requirements in order the make them more efficient. However, the proposed amendments do not alter the Volcker Rule's existing restrictions on the ability of banking entities to engage in proprietary trading and have certain interests in, and relationships with, covered funds.

c. Description of the Rule

The Agencies are proposing to tailor the application of the 2013 final rule based on a banking entity's risk profile and the size and scope of its trading activities. Second, the Agencies aim to further streamline compliance obligations, particularly for entities without large trading operations. Third, the agencies seek to streamline and refine certain definitions and requirements related to the proprietary trading prohibition and limitations on covered fund activities and investments. Please refer to Section II: Overview of Proposal, for further information.

d. Other Statutes and Federal Rules

[268] 13 CFR 121.201 (as amended, effective December 2, 2014).

[269] The FDIC has issued twenty-one FAQs since inception of the 2013 rule.

The FDIC has not identified any likely duplication, overlap, and/or potential conflict between the proposed rule and any other federal rule.

On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act 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. This excludes every FDIC-supervised small entity from the statutory definition of banking entity, except those that are controlled by a company that is not excluded. The SBA has defined "small entities" to include banking organizations with total assets less than or equal to $550 million.[270]

e. Small Entities Affected

The FDIC supervises 3,597 depository institutions,[271] of which, 2,885 are defined as small entity.[272] There are no FDIC-supervised small entities that engage in significant or moderate trading of assets and liabilities at the depository institution level.[273] There are only five FDIC-supervised small entities, which are controlled by companies not excluded by section 13, as amended, that would be required to implement compliance elements prescribed by the proposed rule and would have compliance obligations under the proposed rule, of which one is

[270] 13 CFR 121.201.

[271] FDIC-supervised institutions are set forth in 12 U.S.C. 1813(q)(2).

[272] FDIC Call Report, March 31, 2018.

[273] Based on data from the December 31, 2017 Call Reports and Y9C reports. Top tier institutions that have a four-quarter average trading assets and liabilities, excluding U.S. treasuries and obligations or guarantees of government agencies, exceeding $10 billion have "significant" trading activity while those between $1 billion and $10 billion have "moderate" trading activity and those below $1 billion have "limited" trading activity.

categorized as having "significant" trading, one is categorized as having "moderate" trading and three are categorized as having "limited" trading activity.[274]

f. Expected Effects of the Proposed Rule

The potential benefits of this proposed rule consist of any reduction in the regulatory costs borne by covered entities. The potential costs of this rule consist of any reduction in the efficacy of the objectives in the existing regulatory framework. As explained in the following sections, certain of these potential costs and benefits are difficult to quantify.

1. Expected Costs

By reducing the reporting requirements of the 2013 final rule, there is a chance that the Agencies would fail to recognize prohibited proprietary trading, resulting in additional risk of loss to an institution, the Deposit Insurance Fund (DIF), the financial sector, and the economy. The FDIC believes the potential costs associated with these risks are minimal. First, the reporting metrics that would be removed or replaced by the proposed rule have contributed little as indicators of risk, and there would be no cost associated with replacing them. Second, the banking entities that would be relieved from compliance requirements under section __.20 of the proposed rule are primarily small entities that conduct limited to no trading activity, and which are therefore excluded from Section 13 by the Economic Growth, Regulatory Relief, and Consumer Protection Act. The FDIC would maintain its ability to recognize and respond to potential risks of prohibited activity by these small entities through off-site monitoring of Call Reports as well as periodic on-site examinations. The proposed rule has no additional or

[274] *Id.*

transition costs because the new reporting metrics in the proposed rule consist of data that covered entities already collect in the course of business and for regulatory compliance.

2. Expected Benefits

The potential benefits of the proposed rule can be expressed in terms of the potential reduction in the costs of compliance incurred by small, FDIC-supervised affected banking entities under the proposed rule. These benefits cannot be quantified because covered institutions do not collect data and report to the FDIC the precise burden relating to parts of the 2013 final rule. Nevertheless, supervisory experience and feedback received from FDIC-supervised banking entities have demonstrated that these burdens exist. The proposed rule clarifies many requirements and definitions that are expected to enable banking entities to more efficiently and effectively comply with the rule, thus providing benefits to those entities.

g. Alternatives Considered

The primary alternative to the proposed rule is to maintain the status quo under the 2013 final rule. As discussed above, however, the proposed rule implements the statutory requirements, but is expected to provide more certainty and result in lower costs.

The proposed rule also seeks public comment on alternative regulatory approaches that would reduce the compliance burden of the 2013 final rule without reducing its effectiveness in eliminating the moral hazard of proprietary trading.

h. Certification Statement

Section 13, as amended, exempts almost all of the FDIC-supervised small institutions from compliance with the Volcker Rule. The proposed rule provides benefits to the remaining five FDIC-supervised small institutions with parent companies subject to the rule. Therefore, the

FDIC certifies that this proposed rule will not have a significant economic impact on a substantial number of FDIC-supervised small entities.[275]

i. Request for Comments

The FDIC invites comments on all aspects of the supporting information provided in this RFA section. In particular, would this rule have any significant effect on small entities that the FDIC has not identified? If the proposed rule is implemented, how many hours of burden would small institutions save?

SEC

Pursuant to 5 U.S.C. section 605(b), the SEC hereby certifies that the proposed amendments to the 2013 final rule would not, if adopted, have a significant economic impact on a substantial number of small entities.

As discussed in the **Supplementary Information**, the Agencies are proposing to revise 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 in a manner consistent with section 13 of the BHC Act, the Agencies are proposing to simplify and tailor the rule in a manner that would substantially reduce compliance costs for all banking entities and, in particular, small banking entities and banking entities without significant trading operations.

The proposed revisions would generally apply to banking entities, including certain SEC-registered entities. These entities include bank-affiliated SEC-registered broker-dealers,

[275] Notwithstanding S.2155, the rule does provide benefits to a substantial number of moderate sized banks above $550 million in total assets and below $1 billion in trading assets and liabilities as well as to large banks with very little trading activity.

investment advisers, and security-based swap dealers. Based on information in filings submitted by these entities, the SEC preliminarily believes that there are no banking entity registered investment advisers[276] or broker-dealers[277] that are small entities for purposes of the RFA.[278] For this reason, the SEC believes that the proposed amendments to the 2013 final rule would not, if adopted, have a significant economic impact on a substantial number of small entities.

The SEC encourages written comments regarding this certification. Specifically, the SEC solicits comment as to whether the proposed amendments could have an impact on small entities that has not been considered. Commenters should describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

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[276] 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.

[277] 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).

[278] Based on SEC analysis of Form ADV data, the SEC preliminarily believes that there are not a substantial number of registered investment advisers affected by the proposed amendments that would qualify as small entities under RFA. Based on SEC analysis of broker-dealer FOCUS filings and NIC relationship data, the SEC preliminarily believes that there are no SEC-registered broker-dealers affected by the proposed amendments that would qualify as small entities under RFA. With respect to security-based swap dealers, based on feedback from market participants and our information about the security-based swap markets, the Commission believes that the types of entities that would engage in more than a de minims 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.

CFTC

Pursuant to 5 U.S.C. 605(b), the CFTC hereby certifies that the proposed amendments to the 2013 final rule would not, if adopted, 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 proposing to revise 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 in a manner consistent with section 13 of the BHC Act, the Agencies are proposing to simplify and tailor the rule in a manner that would substantially reduce compliance costs for all banking entities and, in particular, small banking entities and banking entities without significant trading operations.

The proposed revisions would generally apply to banking entities, including certain CFTC-registered entities. These entities include bank-affiliated CFTC-registered swap dealers, FCMs, commodity trading advisors and commodity pool operators.[279] The CFTC has previously determined that swap dealers, futures commission merchants and commodity pool operators are not small entities for purposes of the RFA and, therefore, the requirements of the RFA do not apply to those entities.[280] As for commodity trading advisors, the CFTC has found it appropriate

[279] The proposed revisions may also apply to other types of CFTC registrants that are banking entities, such as introducing brokers, but the CFTC believes it is unlikely that such other registrants will have significant activities that would implicate the proposed revisions. *See* 79 FR 5808, 5813 (Jan. 31, 2014) (CFTC version of 2013 final rule).

[280] *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); Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620 (Jan. 19, 2012) (swap dealers and major swap participants).

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.[281]

In the context of the proposed 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, which the CFTC expects are larger businesses. The CFTC requests that commenters address in particular whether any of these commodity trading advisors, or other CFTC registrants covered by the proposed revisions to the 2013 final rule, are small entities for purposes of the RFA.

Because the CFTC believes that there are not a substantial number of registered, banking entity-affiliated commodity trading advisors 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 proposed revisions to the 2013 final rule would not, if adopted, have a significant economic impact on a substantial number of small entities for which the CFTC is the primary financial regulatory agency.

The CFTC encourages written comments regarding this certification. Specifically, the CFTC solicits comment as to whether the proposed amendments could have a direct impact on small entities that were not considered. Commenters should describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

A. OCC Unfunded Mandates Reform Act of 1995 Determination

[281] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18620 (Apr. 30, 1982).

The OCC analyzed the proposed rule under the factors set forth in the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1532). Under this analysis, the OCC considered whether the proposed 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 annually for inflation).

The OCC has determined this proposed rule is likely to result in the expenditure by the private sector of approximately $11.6 million in the first year. Therefore, the OCC concludes that implementation of the proposed rule would not result in an expenditure of $100 million or more annually by state, local, and tribal governments, or by the private sector.

B. SEC: Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[282] the SEC requests comment on the potential effect of the proposed amendments on the U.S. economy on an annual basis; any potential increase in costs or prices for consumers or individual industries; and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

D. SEC Economic Analysis

1. Broad Economic Considerations

Section 13 of the BHC Act generally prohibits banking entities from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with covered funds, subject to certain exemptions. Under the BHC Act, "banking entities" include insured depository institutions, any company that controls an

[282] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

insured depository institution or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and their affiliates and subsidiaries.[283] Accordingly, certain SEC-regulated entities, such as broker-dealers, security-based swap dealers ("SBSDs"), and registered investment advisers ("RIAs") affiliated with a banking entity, fall under the definition of "banking entity" and are subject to the prohibitions of section 13 of the BHC Act.[284] In addition, the Economic Growth, Regulatory Relief, and Consumer Protection Act, enacted on May 24, 2018, amends section 13 of the BHC Act to exclude from the scope of "insured depository institution" in the banking entity definition any entity that does not have and is not controlled by a company that has (1) more than $10 billion in total consolidated assets; and (2) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5% of total consolidated assets.[285]

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[283] *See* 12 U.S.C. 1851(h)(1).

[284] Throughout this economic analysis, the term "banking entity" generally refers only to banking entities for which the SEC is the primary financial regulatory agency unless otherwise noted. While section 13 of the BHC Act and its associated rules apply to a broader set of banking entities, this economic analysis is limited to those banking entities for which the SEC is the primary financial regulatory agency as defined in section 2(12)(B) of the Dodd-Frank Act. *See* 12 U.S.C. 1851(b)(2); 12 U.S.C. 5301(12)(B).

We recognize that compliance with SBSD registration requirements is not yet required and that there are currently no registered SBSDs. However, the SEC has previously estimated that as many as 50 entities may potentially register as security-based swap dealers and that as many as 16 of these entities may already be SEC-registered broker-dealers. *See* Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48963 (Aug. 14, 2015) ("SBSD and MSP Registration Release").

For the purposes of this economic analysis, the term "dealer" generally refers to SEC-registered broker-dealers and SBSDs.

Throughout this economic analysis, "we" refers only to the SEC and not the other Agencies, except where otherwise indicated.

[285] The legislation also alters the name sharing provisions in section 13(d)(1)(G)(vi). This economic analysis assumes that the legislation's changes to section 13 of the BHC Act are in effect.

The Agencies issued final regulations implementing section 13 of the BHC Act in December 2013, with an initial effective date of April 1, 2014.[286] The 2013 final rule prohibits banking entities (e.g., bank-affiliated broker-dealers, SBSDs, and investment advisers) from engaging, as principal, in short-term trading of securities, derivatives, futures contracts, and options on these instruments, subject to certain exemptions. In addition, the 2013 final rule generally prohibits the same entities from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a "covered fund," subject to certain exemptions. The 2013 final rule defines the term "covered fund" to include any issuer that would be an investment company under the Investment Company Act of 1940 if it were not otherwise excluded by sections 3(c)(1) or 3(c)(7) of that act, as well as certain foreign funds and commodity pools.[287] However, the definition contains a number of exclusions for entities that would otherwise meet the covered fund definition but that the Agencies did not believe are engaged in investment activities contemplated by section 13 of the BHC Act.[288]

In implementing section 13 of the BHC Act, the Agencies sought to increase the safety and soundness of banking entities, promote financial stability, and reduce conflicts of interest between banking entities and their customers.[289] The regulatory regime created by the 2013 final

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[286] *See* 79 FR at 5536. The 2013 final rule was published in the Federal Register on January 31, 2014, and became effective on April 1, 2014. Banking entities were required to fully conform their proprietary trading activities and their new covered fund investments and activities to the requirements of the final rule by the end of the conformance period, which the Board extended to July 21, 2015. The Board extended the conformance period for legacy-covered fund activities until July 21, 2017. Upon application, banking entities also have an additional period to conform certain illiquid funds to the requirements of section 13 and implementing regulations.

[287] *See* 2013 final rule § __.10(b).

[288] *See* 2013 final rule § __.10(c).

[289] *See, e.g.*, 79 FR at 5666, 5574, 5541, 5659. An extensive body of research has examined moral hazard arising out of federal deposit insurance, implicit bailout guarantees, and systemic

rule may enhance regulatory oversight and compliance with the substantive prohibitions but could also impact capital formation and liquidity. The Agencies also recognized that client-oriented financial services, such as underwriting and market making, are critical to capital formation and can facilitate the provision of market liquidity, and that the ability to hedge is fundamental to prudent risk management as well as capital formation.[290]

Section 13 of the BHC Act also provides a number of statutory exemptions to the general prohibitions on proprietary trading and covered funds activities. For example, the statute exempts from the proprietary trading restrictions certain underwriting, market making, and risk-mitigating hedging activities, as well as certain trading activities outside of the United States.[291]

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risk issues. *See, e.g.*, Atkeson, d'Avernas, Eisfeldt, and Weill, 2018, "Government Guarantees and the Valuation of American Banks," working paper. *See also* Bianchi, 2016, "Efficient Bailouts?" American Economic Review 106 (12), 3607-3659; Kelly, Lustig, and Van Nieuwerburgh, 2016, "Too-Systematic-to-Fail: What Option Markets Imply about Sector-Wide Government Guarantees," American Economic Review 106(6), 1278-1319; Anginer, Demirguc-Kunt, and Zhu, 2014, "How Does Deposit Insurance Affect Bank Risk? Evidence from the Recent Crisis," Journal of Banking and Finance 48, 312-321; Beltratti and Stulz, 2012, "The Credit Crisis Around the Globe: Why Did Some Banks Perform Better?" Journal of Financial Economics 105, 1-17; Veronesi and Zingales, 2010, "Paulson's Gift," Journal of Financial Economics 97(3). 339-368. For a literature review, *see*, *e.g.*, Benoit, Colliard, Hurlin, and Perignon, 2017, "Where the Risks Lie: A Survey on Systemic Risk," Review of Finance 21(1), 109-152.

See also, e.g., Avci, Schipani, and Seyhun, 2017, "Eliminating Conflicts of Interests in Banks: The Significance of the Volcker Rule," Yale Journal on Regulation 35 (2).

[290] *See, e.g.,* 79 FR at 5541, 5546, 5561. In addition, a significant amount of research has focused on changes in liquidity provision following the financial crisis and regulatory reforms. *See, e.g.*, Bessembinder, Jacobsen, Maxwell, and Venkataraman 2017, "Capital Commitment and Illiquidity in Corporate Bonds," Journal of Finance, forthcoming. *See also* Bao, O'Hara and Zhou, 2017, "The Volcker Rule and Corporate Bond Market Making in Times of Stress," Journal of Financial Economics, forthcoming. Bao et al. (2017) shows that dealers not subject to the Volcker rule increased their market-making activities, partially offsetting the reduction market making by dealers affected by the Volcker Rule. *See also*, Anderson and Stulz, 2017, "Is Post-Crisis Bond Liquidity Lower?" working paper; Goldstein and Hotchkiss, 2017, "Providing Liquidity in an Illiquid Market: Dealer Behavior in U.S. Corporate Bonds," working paper.

[291] *See* 12 U.S.C. 1851(d).

Similarly, section 13 provides exemptions for certain covered funds activities, such as exemptions for organizing and offering covered funds.[292] The 2013 final rule implemented these exemptions.[293] In addition, some banking entities engaged in proprietary trading are required to furnish periodic reports that include a variety of quantitative measurements of their covered trading activities, and banking entities engaged in activities covered by section 13 of the BHC Act and the 2013 final rule are required to establish a compliance program reasonably designed to ensure and monitor compliance with the 2013 final rule.[294]

Certain aspects of the rule may have resulted in a complex and costly compliance regime that is unduly restrictive and burdensome on some affected banking entities, particularly smaller firms that do not qualify for the simplified compliance and reporting regime. The Agencies also recognize that distinguishing between permissible and prohibited activities may be complex and costly for some firms. Moreover, the 2013 final rule may have included in its scope some groups of market participants that do not necessarily engage in the activities or pose the risks that section 13 of the BHC Act intended to address. For example, the 2013 final rule's definition of the term "covered fund" is broad and, as a result, may include funds that do not engage in the investment activities contemplated by section 13 of the BHC Act. As another example, foreign banking entities' ability to trade financial instruments in the United States may have been significantly limited despite the foreign trading exemption in the 2013 final rule.

The amendments to the 2013 final rule proposed in this release include those that influence the scope of permitted activities for all or a subset of banking entities and covered

[292] *See* section 13(d)(1)(G) of the BHC Act.

[293] *See* 2013 final rule §§ __.4, __.5, __.6, __.11, __.13.

[294] *See* 2013 final rule § __.20.

funds, and those that simplify, tailor, or eliminate the application of certain aspects of the rule to reduce compliance and reporting burdens.

Some of the proposed amendments affect the scope of permitted activities (e.g., foreign trading, underwriting, market making, and risk-mitigating hedging). These changes would expand the scope of permitted activities, which may benefit the parties to those transactions and broader capital markets, for example, if reduced compliance costs translate into increased willingness of banking entities to underwrite securities or make markets. These changes also, however, could facilitate risk-taking or create conflicts of interest among certain groups of market participants. Moreover, amendments that redefine the scope of entities subject to certain provisions of the rule may impact competition, allocative efficiency, and capital formation. Broadly, to the extent that the proposed amendments and changes on which the Agencies are requesting comment increase or decrease the scope of permissible activities, they may magnify or attenuate the economic tradeoffs above. As we discuss below, to the extent that the proposed amendments or changes on which the Agencies are requesting comments reduce burdens on some groups of market participants (e.g., on entities without significant trading assets and liabilities, foreign banking entities, certain types of covered funds), the proposed amendments may increase competition and trading activity in various market segments.

Other proposed amendments reduce compliance program, reporting, and documentation requirements for some entities. While these amendments are designed to reduce the compliance burdens of regulated entities, they may also reduce the efficacy of regulatory oversight, internal compliance, and supervision. Amendments and changes on which the Agencies are requesting comment that decrease (or increase) compliance program and reporting requirements tip the balance of economic tradeoffs toward (or away from) competition, trading activity, and capital

formation on the one hand, and against (or in favor of) regulatory and internal oversight on the other. However, as discussed below, some of the changes need not reduce the efficacy of the Agencies' regulatory oversight. Further, under the proposal, banking entities (other than banking entities with limited trading assets and liabilities for which the proposed presumption of compliance has not been rebutted) would still be required to develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions set forth in section 13 of the BHC Act and the 2013 final rule, as it is proposed to be amended.

Where possible, we have attempted to quantify the costs and benefits expected to result from the proposed amendments. In many cases, however, the SEC is unable to quantify these potential economic effects. Some of the primary economic effects, such as the effect on incentives that may give rise to conflicts of interest in various regulated entities and the efficacy of regulatory oversight under various compliance regimes, are inherently difficult to quantify. Moreover, some of the benefits of the 2013 final rule's definitions and prohibitions that are being amended here, for example potential benefits for resilience during a crisis, are less readily observable under strong economic conditions. Lastly, because of overlapping implementation periods of various post-crisis regulations affecting the same group of SEC registrants, the long implementation timeline of the 2013 final rule, and the fact that many market participants changed their behavior in anticipation of future changes in regulation, it is difficult to quantify the net economic effects of the individual amendments to rule provisions proposed here.

In some instances, we lack the information or data necessary to provide reasonable estimates for the economic effects of the proposed amendments. For example, we lack information and data on the volume of trading activity that does not occur because of uncertainty

about how to demonstrate that underwriting or market-making activities satisfy the RENTD requirement; the extent to which internally-set risk limits capture expected customer demand; how accurately correlation analysis reflects underlying exposures of banking entities with, and without, significant trading assets and liabilities in normal times and in times of market stress; the feasibility and costs of reorganization that may enable some U.S. banking entities to become foreign banking entities for the purposes of relying on the foreign trading exemption; how market participants may choose to restructure their interests in various types of private funds in response to the proposed amendments or other changes on which the Agencies seek comment; the amount of capital formation in covered funds that does not occur because of current covered fund provisions, including those concerning underwriting, market making, or hedging with covered funds; or the volume of loans, guarantees, securities lending, and derivatives activity dealers may wish to engage in with the covered funds they advise; the extent of risk reduction associated with the 2013 final rule. Where we cannot quantify the relevant economic effects, we discuss them in qualitative terms.

In addition, the broader economic effects of the proposed amendments, such as those related to efficiency, competition, and capital formation, are difficult to quantify with any degree of certainty. The proposed amendments tailor, remove, or alter the scope of requirements in the 2013 final rule. Thus, some of the methodological challenges in analyzing market effects of these amendments are somewhat similar to those that arise when analyzing the effects of the 2013 final rule. As we have noted elsewhere, analysis of the effects of the implementation of the 2013 final rule is confounded by, among others, macroeconomic factors, other policy interventions, post-crisis changes to market participants' risk aversion and return expectations, and technological advancements unrelated to regulations. Because of the extended timeline of

implementation of section 13 of the BHC Act and the overlap of the 2013 final rule period with other post-crisis changes affecting the same group of SEC registrants, typical quantitative methods that might otherwise enable causal attribution and quantification of the effects of section 13 of the BHC Act and the 2013 final rule on measures of capital formation, liquidity, and informational or allocative efficiency are not available. Where existing research has sought to test causal effects and to measure them quantitatively, the presence, direction, and magnitude of the effects are sensitive to econometric methodology, measurement, choice of market, and the time period studied.[295] Moreover, empirical measures of capital formation or liquidity do not reflect issuance and transaction activity that does not occur as a result of the implementing rules. Accordingly, it is difficult to quantify the primary issuance and market liquidity that would have been observed following the financial crisis absent the ensuing reforms. Finally, since section 13 of the BHC Act and the 2013 final rule combined a number of different requirements, it is difficult to attribute the observed effects to a specific provision or set of requirements.

In addition, the existing securities markets—including market participants, their business models, market structure, etc.—differ in significant ways from the securities markets that existed prior to the 2013 final rule's implementation. For example, the role of dealers in intermediating trading activity has changed in important ways, including: bank-dealer capital commitment declined while non-bank dealer capital commitment increased; electronic trading in some securities markets became more prominent; the profitability of trading after the financial crisis may have decreased significantly; and the introduction of alternative credit markets may have contributed to liquidity fragmentation across markets.[296]

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[295] *See, e.g.*, Access to Capital and Market Liquidity *supra* note 106.

[296] *See, e.g.*, Bessembinder et al. (2017), Bao et al. (2017), Anderson and Stulz (2017). *See also*, Trebbi and Xiao, 2018, "Regulation and Market Liquidity," Management Science, forthcoming;

The SEC continues to recognize that post-crisis financial reforms in general, and the 2013 final rule in particular, impose costs on certain groups of market participants. Since the rule became effective, new estimates regarding compliance burdens and new information about the various effects of the final rule have become available. The passage of time has also enabled an assessment of the value of individual requirements that enable SEC oversight, such as the requirement to report certain quantitative metrics, relative to compliance burdens. This and other information and considerations inform the SEC's economic analysis.

From the outset, we note that this analysis is limited to areas within the scope of the SEC's function as the primary securities markets regulator in the United States. In particular, the SEC's economic analysis is focused on the potential effects of the proposed amendments on SEC registrants, the functioning and efficiency of the securities markets, and capital formation. Specifically, this economic analysis generally concerns entities subject to the 2013 final rule for which the SEC is the primary financial regulatory agency, including SEC-registered broker-dealers, SBSDs, and RIAs.[297] In addition, the analysis of the covered funds provisions discusses their economic effects on covered funds as well as the economic effects of the Agencies modifying the definition of covered funds. Thus, the below analysis does not consider broker-dealers, SBSDs, and investment advisers that are not banking entities, and banking entities that are not SEC registrants, beyond the potential spillover effects on these entities and effects on efficiency, competition, and capital formation in securities markets.

Oehmke and Zawadowski, 2017, "The Anatomy of the CDS Market," Review of Financial Studies 30(1), 80-119.

[297] *See* Responses to Frequently Asked Questions Regarding the Commission's Rule under Section 13 of the Bank Holding Company Act (the "Volcker Rule"), June 10, 2014; Updated March 4, 2016, *available at* https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm (providing background on the application of the Commission's rule).

2. Overview of the Baseline

In the context of this economic analysis, the economic costs and benefits, and the impact of the proposed amendments on efficiency, competition, and capital formation, are considered relative to a baseline that includes the 2013 final rule and recent legislative amendments as applicable and current practices aimed at compliance with these regulations.

a. Regulation

To assess the economic impact of the proposed rule, we are using as our baseline the legal and regulatory framework as it exists at the time of this release. Thus, the regulatory baseline for our economic analysis includes section 13 of the BHC Act as amended by the Economic Growth, Regulatory Relief, and Consumer Protection Act and the 2013 final rule. Further, our baseline accounts for the fact that since the adoption of the 2013 final rule, the staffs of the Agencies have provided FAQ responses related to the regulatory obligations of banking entities, including SEC-regulated entities that are also banking entities under the 2013 final rule, which likely influenced these entities' means of compliance with the 2013 final rule.[298] In addition, the Federal banking agencies released a 2017 policy statement with respect to foreign excluded funds.[299]

Three major areas of the 2013 final rule—proprietary trading restrictions, covered fund restrictions, and compliance requirements—are relevant to establishing an economic baseline. First, with respect to proprietary trading restrictions, the features of the existing regulatory framework relevant to the baseline of this economic analysis include definitions of "trading account" and "trading desk;" requirements for permissible underwriting, market making, and

[298] *See id.*

[299] *See* Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act *supra* note 48.

risk-mitigating hedging activities; the liquidity management exclusion; treatment of error-related trades; restrictions on transactions between foreign banking entities and their U.S.-dealer affiliates; and the compliance and metrics-reporting requirements for dealers affiliated with banking entities. The potential that a RIC or a BDC would be treated as a banking entity where the fund's sponsor is a banking entity and holds 25% of more of the RIC or BDC's voting securities after a seeding period also forms part of our baseline.

Second, with respect to the restrictions on covered funds, the features of the existing regulatory framework under the 2013 final rule relevant to the baseline include the definition of the term "covered fund;" restrictions on a banking entity's relationships with covered funds; and restrictions on underwriting, market making, and hedging with covered funds.

Third, with respect to compliance, relevant requirements include the 2013 final rule's compliance program requirements, including those under § __.20 and Appendix B, as well as recordkeeping and reporting of metrics under Appendix A.

The 2013 final rule differentiates banking entities on the basis of certain monetary thresholds, including the size of consolidated trading assets and liabilities of their parent company. More specifically, U.S. banking entities that have, together with affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which (on a worldwide consolidated basis) over the previous consecutive four quarters, as measured as of the last day of each of the four prior calendar quarters, equals $10 billion or more are currently subject to reporting requirements of Appendix A of the 2013 final rule. Entities below this threshold do not need to comply with Appendix A. Additionally, banking entities with total consolidated assets of $10 billion or less as reported on December 31

of the previous 2 calendar years that engage in covered activities qualify for the simplified compliance regime, and banking entities that have $50 billion or more in total consolidated assets and banking entities with over $10 billion in consolidated trading assets and liabilities are currently subject to the requirement to adopt an enhanced compliance program pursuant to Appendix B.

In the sections that follow we discuss rule provisions currently in effect, how each proposed amendment changes regulatory requirements, and the anticipated costs and benefits of the proposed amendments.

b. Affected participants

The SEC-regulated entities directly affected by the proposed amendments include broker-dealers, security-based swap dealers, and investment advisers.

i. Broker-Dealers[300]

Under the 2013 final rule, some of the largest SEC-regulated broker-dealers are banking entities. Table 1 reports the number, total assets, and holdings of broker-dealers by the broker-dealer's bank affiliation.

While the 3,658 domestic broker-dealers that are not affiliated with holding companies greatly outnumber the 138 banking entity broker-dealers subject to the 2013 final rule, these banking entity broker-dealers dominate non-banking entity broker-dealers in terms of total assets (74% of total broker-dealer assets) and aggregate holdings (72% of total broker-dealer holdings).

[300] Data sources included Reporting Form FR Y-9C data for domestic holding companies on a consolidated basis and Report of Condition and Income data for banks regulated by the Board, FDIC, and OCC as of Q3 2017. Broker-dealer bank affiliations were obtained from the Federal Financial Institutions Examination Council's (FFIEC) National Information Center (NIC). Broker-dealer assets and holdings were obtained from FOCUS Report data for Q3 2017.

Table 1. Broker-dealer count, assets, and holdings by affiliation.

Broker-dealer affiliation	#	Total assets, $mln[301]	Holdings, $mln[302]	Holdings (alternative), $mln[303]
Affected bank broker-dealers[304]	138	3,039,337	724,706	536,555
Other bank broker-dealers[305]	124	125,595	12,312	5,582
Non-bank broker-dealers	3,658	929,240	270,876	151,516
Total	3,920	4,094,172	1,007,894	693,653

Some of the changes being proposed to the 2013 final rule differentiate banking entities on the basis of their consolidated trading assets and liabilities.[306] Table 2 reports the distribution of broker-dealer banking entities' counts, assets, and holdings by consolidated trading assets and liabilities of the (top-level) parent firm. We estimate that 89 broker-dealer affiliates of firms with less than $10 billion in consolidated trading assets and liabilities account for 7% of bank-affiliated broker-dealer assets and 5% of holdings (or 3% using the alternative measure of holdings). These figures may overestimate or underestimate the number of affected broker-

[301] Broker-dealer total assets are based on FOCUS report data for "Total Assets."

[302] Broker-dealer holdings are based on FOCUS report data for securities and spot commodities owned at market value, including bankers' acceptances, certificates of deposit and commercial paper, state and municipal government obligations, corporate obligations, stocks and warrants, options, arbitrage, other securities, U.S. and Canadian government obligations, and spot commodities.

[303] This alternative measure excludes U.S. and Canadian government obligations and spot commodities.

[304] This category includes all banking entity broker-dealers except those affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, and those for which bank trading asset and liability data was not available.

[305] This category includes all banking entity broker-dealers affiliated with firms that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, as well as banking entity broker-dealers for which bank trading asset and liability data was not available.

[306] *See, e.g.*, 2013 final rule § __.20(d)(1).

dealers as they may include broker-dealers that do not engage in various types of covered trading activity.

Table 2. Broker-dealer counts, assets, and holdings by consolidated trading assets and liabilities of the banking entity.[307]

Consolidated trading assets and liabilities[308]	#	%	Total assets, $mln	%	Holdings, $mln	%	Holdings (altern.), $mln	%
≥50bln	29	21	2,215,295	73	554,125	76	492,017	92
25bln-50bln	8	6	417,099	14	76,865	11	21,083	4
10bln-25bln	12	9	184,591	6	58,232	8	7,494	1
5bln-10bln	24	17	145,151	5	23,321	3	10,527	2
1bln-5bln	23	17	9,756	0	3,628	1	1,795	0
≤1bln	42	30	67,446	2	8,534	1	3,638	1
Total	138	100	3,039,338	100	724,705	100	$536,554	100

ii. **Security-Based Swap Dealers**

The proposed amendments may also affect bank-affiliated SBSDs. As compliance with SBSD registration requirements is not yet required, there are currently no registered SBSDs. However, the SEC has previously estimated that as many as 50 entities may potentially register as security-based swap dealers and that as many as 16 of these entities may already be SEC-

[307] This analysis excludes SEC-registered broker-dealers affiliated with firms that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, as well as firms for which bank trading asset and liability data was not available.

[308] Consolidated trading assets and liabilities are estimated using information reported in form Y-9C data. These estimates exclude from the definition of consolidated trading assets and liabilities Treasury securities - we subtract from the sum of total trading assets and liabilities reported in items BHCK3545 and BHCK3547 trading assets that are U.S. Treasury securities as reported in item BHCK3531 and calculate average trading assets and liabilities using 2016Q4 through 2017Q3 data. However, our estimates do not exclude agency securities as such information is not otherwise available. Thus, these figures may overestimate or underestimate the number of affected bank affiliated broker-dealers. We also note that we do not have data on worldwide consolidated trading assets and liabilities of foreign banking entities with which some SEC registrants are affiliated, and consolidated trading assets and liabilities for such foreign banking entities are calculated based on their U.S. operations. Thus, the figures may overestimate or underestimate the number of affected bank affiliated broker-dealers.

registered broker-dealers.[309] Given our analysis of DTCC Derivatives Repository Limited Trade Information Warehouse ("TIW") transaction and positions data on single-name credit-default swaps, we preliminarily believe that all entities that may register with the SEC as SBSDs are bank-affiliated firms, including those that are SEC-registered broker-dealers. Therefore, we preliminarily estimate that, in addition to the bank-affiliated SBSDs that are already registered as broker-dealers and included in the discussion above, as many as 34 other bank-affiliated SBSDs may be affected by the proposed amendments.

Importantly, capital and other substantive requirements for SBSDs under Title VII of the Dodd-Frank Act have not yet been adopted. We recognize that firms may choose to move security-based swap trading activity into (or out of) an affiliated bank or an affiliated broker-dealer instead of registering as a standalone SBSD, if bank or broker-dealer capital and other regulatory requirements are less (or more) costly than those that may be imposed on SBSDs under Title VII. As a result, the above figures may overestimate or underestimate the number of SBSDs that are not broker-dealers and that may become SEC-registered entities that would be affected by the proposed amendments. Quantitative cost estimates are provided separately for affected broker-dealers and potential SBSDs.

[309] *See* SBSD and MSP Registration Release, *supra* note 284.

iii. **Private Funds and Private Fund Advisers**[310]

In this section, we focus on RIAs advising private funds. Using Form ADV data, Table 3 reports the number of RIAs advising private funds by fund type, as those types are defined in Form ADV. Table 4 reports the number and gross assets of private funds advised by RIAs and separately reports these statistics for banking entity RIAs. As can be seen from Table 3, the two largest categories of private funds advised by RIAs are hedge funds and private equity funds.

Banking entity RIAs advise a total of 4,250 private funds with approximately $2 trillion in gross assets. Using Form ADV data, we observe that banking entity RIAs' gross private fund assets under management is concentrated in hedge funds and private equity funds. We estimate on the basis of this data that banking entity RIAs advise 947 hedge funds with approximately $616 billion in gross assets and 1,282 private equity funds with approximately $350 billion in assets. While banking entity RIAs are subject to all of section 13's restrictions, because RIAs do not typically engage in proprietary trading, we preliminarily believe that they will not be impacted by the proposed amendments related to proprietary trading.

Table 3. SEC-registered investment advisers advising private funds by fund type.[311]

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[310] These estimates are calculated from Form ADV data as of March 31, 2018. We define an investment adviser as a "private fund adviser" if it indicates that it is an adviser to any private fund on Form ADV Item 7.B. We define an investment adviser as a "banking entity RIA" if it indicates on Form ADV Item 6.A.(7) that it is actively engaged in business as a bank, or it indicates on Form ADV Item 7.A.(8) that it has a "related person" that is a banking or thrift institution. For purposes of Form ADV, a "related person" is any advisory affiliate and any person that is under common control with the adviser. We recognize that the definition of "control" for purposes of Form ADV, which is used in identifying related persons on the form, differs from the definition of "control" under the BHC Act. In addition, this analysis does not exclude SEC-registered investment advisers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets. Thus, these figures may overestimate or underestimate the number of banking entity RIAs.

[311] This table includes only the advisers that list private funds on Section 7.B.(1) of Form ADV. The number of advisers in the "Any Private Fund" row is not the sum of the rows that follow

Fund type	All RIA	Banking entity RIA
Hedge Funds	2,691	173
Private Equity Funds	1,538	90
Real Estate Funds	486	56
Securitized Asset Funds	222	43
Venture Capital Funds	173	16
Liquidity Funds	46	7
Other Private Funds	1,043	148
Total Private Fund Advisers	4,660	308

Table 4. The number and gross assets of private funds advised by SEC-registered investment advisers.[312]

Fund type	Number of private funds		Gross assets, $bln	
	All RIA	Banking entity RIA	All RIA	Banking entity RIA
Hedge Funds	10,329	947	7,081	616
Private Equity Funds	13,588	1,282	2,919	350
Real Estate Funds	3,252	323	564	84
Securitized Asset Funds	1,707	360	562	120
Liquidity Funds	1,073	29	109	190
Venture Capital Funds	76	42	291	2
Other Private Funds	4,337	1,268	1,568	689
Total Private Funds	34,359	4,250	13,093	2,052

Banking entity RIAs advise a total of 4,250 private funds with approximately $2 trillion in gross assets. Using Form ADV data, we observe that banking entity RIAs' gross private fund assets under management is concentrated in hedge funds and private equity funds. We estimate on the basis of this data that banking entity RIAs advise 947 hedge funds with approximately $616 billion in gross assets and 1,282 private equity funds with approximately $350 billion in assets. While banking entity RIAs are subject to all of section 13's restrictions, because RIAs do

since an adviser may advise multiple types of private funds. Each listed private fund type (e.g., real estate fund, liquidity fund) is defined in Form ADV, and those definitions are the same for purposes of the SEC's Form PF.

[312] Gross assets include uncalled capital commitments on Form ADV.

not typically engage in proprietary trading, we preliminarily believe that they will not be impacted by the proposed amendments related to proprietary trading.

iv. **Registered Investment Companies**

Based on SEC filings and public data, we estimate that, as of January 2018, there were approximately 15,500 RICs[313] and 100 BDCs. Although RICs and BDCs are generally not banking entities themselves subject to the 2013 final rule, they may be indirectly affected by the 2013 final rule and the proposed amendments to the extent that their advisers are banking entities. For instance, banking entity RIAs or their affiliates may reduce their level of investment in the funds they advise, or potentially close these funds, to avoid these funds becoming banking entities themselves. As discussed in more detail in section III.A, however, the Agencies have made clear that nothing in the proposal would modify the application of the staff FAQs discussed above, and the Agencies will not treat RICs (or FPFs) that meet the conditions included in the applicable staff FAQs as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs. In addition, and also as discussed in more detail in section III.A, to accommodate the pendency of the proposal, for an additional period of one year until July 21, 2019, the Agencies will not treat qualifying foreign excluded funds that meet the conditions included in the policy statement discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the policy statement.

[313] For the purposes of this analysis, the term RIC refers to the fund or series, not the legal entity.

3. Economic Effects

a. Treatment of Entities Based on the Size of Trading Assets and Liabilities

i. Costs and Benefits

The proposal categorizes banking entities into three groups on the basis of the size of their trading activity: (1) banking entities with significant trading assets and liabilities, (2) banking entities with moderate trading assets and liabilities, and (3) banking entities with limited trading assets and liabilities. Banking entities with significant trading assets and liabilities are defined as those that have, together with affiliates and subsidiaries, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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, equaling or exceeding $10 billion.[314] Banking entities with limited trading assets and liabilities are defined as those that have, together with affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which 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. Finally, banking entities with moderate trading assets and liabilities are defined as those that are neither banking entities with significant trading assets and liabilities nor banking entities with limited trading assets and liabilities.

[314] With respect to a banking entity that is a foreign banking organization or a subsidiary of a foreign banking organization, this threshold for having significant trading assets and liabilities would apply based on the trading assets and liabilities of the combined U.S. operations, including all subsidiaries, affiliates, branches and agencies.

We further refer to SEC-registered broker-dealer, investment adviser, and SBSD affiliates of banking entities with significant trading assets and liabilities as "Group A" entities, to affiliates of banking entities with moderate trading assets and liabilities as "Group B" entities, and to affiliates of banking entities with limited trading assets and liabilities as "Group C" entities.

Under the proposed amendments, Group A entities would be required to comply with a streamlined but comprehensive version of the 2013 final rule's compliance program requirements, as discussed below. Group B entities would be subject to reduced requirements and an even more tailored approach in light of their smaller and less complex trading activities. The burdens are further reduced for Group C entities, for which the proposed rule establishes presumed compliance, which can be rebutted by the Agencies. We discuss the economic effects of each of the substantive amendments on these groups of entities in the sections that follow.

This economic analysis is focused on the expected economic effects of the proposed amendments on SEC registrants. Table 2 in the economic baseline quantifies broker-dealer activity by gross trading assets and liabilities of banking entities they are affiliated with. We estimate that there are approximately 89 broker-dealers affiliated with firms that have less than $10 billion in consolidated trading assets and liabilities (Group B and Group C broker-dealers). Group B and Group C broker-dealers account for approximately 7% of assets and 5% (or 3% on the basis on the alternative measure of holdings) of total bank broker-dealer holdings.

The primary effects of the proposed amendments for SEC registrants are reduced compliance burdens for Group B and Group C entities, as discussed in more detail in later sections. To the extent that the compliance costs of Group B and Group C entities are currently passed along to customers and counterparties, some of the cost reductions for these entities

associated with the proposed amendments may flow through to counterparties and clients in the form of reduced transaction costs or a greater willingness to engage in activity, including intermediation that facilitates risk-sharing.

The proposed $10 billion threshold would leave firms with moderate trading assets and liabilities with reduced compliance program requirements and more tailored supervision. The proposed $1 billion threshold would leave firms with limited trading assets and liabilities presumed compliant with all proprietary trading and covered fund activity prohibitions. We note that, from above, Group B and Group C broker-dealers currently account for only 3% to 5% of total bank broker-dealer holdings. To the extent that holdings reflect risk exposure resulting from trading activity, current trading activity by Group B and Group C entities may represent lower risks than the risks posed by covered trading of Group A entities.

We recognize that some Group B and Group C entities that currently exhibit low levels of trading activity because of the costs of compliance may respond to the proposed amendments by increasing their trading assets and liabilities while still remaining under the $10 billion and $1 billion thresholds at the holding company level. Increases in aggregate risk-taking by Group B and Group C entities may be magnified if trading activity becomes more highly correlated among such entities, or dampened if trading activity becomes less correlated among such entities. Since it is difficult to estimate the number of Group B and Group C entities that may increase their risk-taking and the degree to which their trading activity would be correlated, the implications of this effect for aggregate risk-taking and capital market activity are unclear.

Such shifts in risk-taking may have two competing effects. On the one hand, if Group B and Group C entities are able to bear risk at a lower cost than their customers, increased risk-taking could promote secondary market trading activity and capital formation in primary

markets, and increase access to capital for issuers. On the other hand, depending on the risk-taking incentives of Group B and Group C firms, increased risk-taking may result in increased moral hazard and market fragility, could exacerbate conflicts of interest between banking entities and their customers, and could ultimately negatively impact issuers and investors. However, we note that the proposed amendments are focused on tailoring the compliance regime based on the amount of covered activity engaged in by each banking entity, and all banking entities would still be subject to the prohibitions related to such covered activities. Thus, the magnitude of increased moral hazard, market fragility, and the severity of conflicts of interest effects may be attenuated.

In response to the proposed amendments, trading activity that was once consolidated within a small number of unaffiliated banking entities may become fragmented among a larger number of unaffiliated banking entities that each "manage down" their trading books under the $10 billion and $1 billion trading asset and liability thresholds to enjoy reduced hedging compliance and documentation requirements and a less costly compliance and reporting regime described in sections V.D.3.c, V.D.3.d, and V.D.3.i. The extent to which banking entities may seek to manage down their trading books will likely depend on the size and complexity of each banking entity's trading activities and organizational structure, along with those of its affiliated entities, as well as forms of potential restructuring and the magnitude of expected compliance savings from such restructuring relative to the cost of restructuring. We anticipate that the incentives to manage the trading book under the $10 billion and $1 billion thresholds may be strongest for those holding companies that are just above the thresholds. Such management of the trading book may reduce the size of trading activity of some banking entities and reduce the number of banking entities subject to more stringent hedging, compliance, and reporting

requirements. At the same time, to the degree that the proposed amendments incentivize banking entities to have smaller trading books, they may mitigate moral hazard and reduce market impacts from the failure of a given banking entity.

ii. **Efficiency, Competition, and Capital Formation**

The 2013 final rule currently imposes compliance burdens that may be particularly significant for smaller market participants. Moreover, such compliance burdens may be passed along to counterparties and customers in the form of higher costs, reduced capital formation, or a reduced willingness to transact. For example, one commenter estimated that the funding cost for an average non-financial firm may have increased by as much as $30 million after the 2013 final rule's implementation.[315] At the same time, and as discussed above in section V.D.1, the SEC continues to recognize that the 2013 final rule may have yielded important qualitative benefits, such as reducing moral hazard and potential incentive conflicts that could be posed by certain types of proprietary trading by dealers, and enhancing oversight and supervision.

On one hand, as a result of the proposed amendments, Group B and Group C entities might enjoy a competitive advantage relative to similarly situated Group A and Group B entities respectively. As noted, firms that are close to the $10 billion threshold may actively manage their trading book to avoid triggering stricter requirements, and some firms above the threshold may seek to manage down the trading activity to qualify for streamlined treatment under the proposed amendments. As a result, the proposed amendments may result in greater competition between Group B and Group A entities around the $10 billion threshold, and similarly, between Group B and Group C entities around the $1 billion threshold. On the other hand, to the extent that Group B and Group C entities increase risk-taking as they compete with Group A and Group

[315] *See supra* note 18.

B entities, respectively, investors may demand additional compensation for bearing financial risk. A higher required rate of return and higher cost of capital could therefore offset potential competitive advantages for Group B and Group C entities.

We recognize that cost savings to Group B and Group C entities related to the reduced hedging documentation requirements and compliance requirements described in sections V.D.3.d and V.D.3.i may be partially or fully passed along to clients and counterparties. To the extent that hedging documentation and compliance requirements for Group B and Group C entities are currently resulting in a reduced willingness to make markets or underwrite placements, the proposed amendments may facilitate trading activity and risk-sharing, as well as capital formation and reduced costs of access to capital. Crucially, the proposed amendments do not eliminate substantive prohibitions under the 2013 final rule but create a simplified compliance regime for entities affiliated with firms without significant trading assets and liabilities. Thus, the 2013 final rule's restrictions on proprietary trading and covered funds activities will continue to apply to all affected entities, including Group B and Group C entities.

iii. **Alternatives**

The Agencies could have taken alternative approaches. For example, the proposed rule could have used other values for thresholds for total consolidated trading assets and liabilities in the definition of entities with significant trading assets and liabilities. As noted in the discussion of the economic baseline, using different thresholds would affect the scope of application of the hedging documentation, compliance program and metrics-reporting requirements by changing the number and size of affected dealers. For instance, using a $1 billion or a $5 billion threshold in a definition of significant trading assets and liabilities would scope a larger number of entities into Group A, as compared to the proposed $10 billion threshold, thereby subjecting a larger share of the dealer and investment adviser industries to six-pillar compliance obligations.

However, we continue to recognize that trading activity is heavily concentrated in the right tail of the distribution, and using a lower threshold would not significantly increase the volume of trading assets and liabilities scoped into the Group A regime. For example, Table 2 shows that 65 broker-dealers affiliated with banking entities that have less than $5 billion in consolidated trading assets and liabilities and are subject to section 13 of the BHC Act as amended by the Economic Growth, Regulatory Relief, and Consumer Protection Act account for only 2.5% of bank-affiliated broker-dealer assets and between 1.7% and 1% of holdings. Alternatively, 42 broker-dealer affiliates of firms that have less than $1 billion in consolidated trading assets and liabilities and are subject to section 13 of the BHC Act account for only 2% of bank-affiliated broker-dealer assets and 1% of holdings. At the same time, with a lower threshold, more banking entities would face higher compliance burdens and related costs.

The Agencies also could have proposed a percentage-based threshold for determining whether a banking entity has significant trading assets and liabilities. For example, the proposed amendment could have relied exclusively on threshold where banking entities are considered to be entities with significant trading assets and liabilities if the firm's total consolidated trading assets and liabilities are above a certain percentage (for example, 10% or 25%) of the firm's total consolidated assets. Under this alternative, a greater number of entities may benefit from lower compliance costs and a streamlined regime for Group B entities. However, under this approach, even firms in the extreme right tail of the trading asset distribution could be considered without significant trading assets and liabilities if they are also in the extreme right tail of the total assets distribution. Thus, without placing an additional limit on total assets within such regime, entities with the largest trading books may be scoped into the Group B regime if they also have a

sufficiently large amount of total consolidated assets, while entities with significantly smaller trading books could be categorized as Group A entities if they have fewer assets overall.

Alternatively, the Agencies could have relied on a threshold based on total assets. However, a threshold based on total assets may not be as meaningful as a threshold based on trading assets and liabilities being proposed here when considered in the context of section 13 of the BHC Act. A threshold based on total assets would scope in entities based merely on their balance sheet size, even though they may have little or no trading activity, notwithstanding the fact that the moral hazard and conflicts of interest that section 13 of the BHC Act are intended to address are more likely to arise out of such trading activity (and not necessarily from the banking entity size, as measured by total consolidated assets). However, it is possible that losses on small trading portfolios can be amplified through their effect on non-trading assets held by a firm. To that extent, a threshold based on total assets may be useful in potentially capturing both direct and indirect losses that originate from trading activity of a holding company.

The Agencies also could have based the thresholds on the level of total revenues from permitted trading activities. To the extent that revenues could be a proxy for the structure of a banking entity's business and the focus of its operations, this alternative may apply more stringent compliance requirements to those entities profiting the most from covered activities. However, revenues from trading activity fluctuate over time, rising during economic booms and deteriorating during crises and liquidity freezes. As a result, under the alternative, a banking entity that is scoped in the regulatory regime during normal times may be scoped out during the time of market stress due to a decrease in the revenues from permitted activities. That is, under such alternative, the weakest compliance regime may be applied to banking entities with the

largest trading books in times of acute market stress, when the performance of trading desks is deteriorating and the underlying requirements of the 2013 final rule may be the most valuable.

Finally, the Agencies could have excluded from the definition of entities with significant trading assets and liabilities those entities that may be affiliated with a firm with over $10 billion in consolidated trading assets and liabilities but that are operated separately and independently from its affiliates and that have total trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) under $10 billion. We do not have data on the number of dealers that are operated "separately and independently" from affiliated entities with significant trading assets and liabilities. However, as shown in Table 5, this alternative could decrease the scope of application of the Group A regime.

Table 5. Broker-dealer assets and holdings by gross trading asset and liability threshold of affiliated banking entities.

Type of broker-dealer	#	Total assets, $mln	Holdings, $mln	Holdings (altern.), $mln
Holdings ≥$10bln and affiliated with firms with gross trading assets and liabilities ≥$10bln	14	2,538,656	668,283	515,443
Holdings <$10bln and affiliated with firms with gross trading assets and liabilities ≥$10bln	35	278,329	20,940	5,152
Affiliated with firms with gross trading assets and liabilities <$10bln[316]	89	222,352	35,483	15,960
Total	138	3,039,337	724,706	536,555

[316] This category excludes SEC-registered broker-dealers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, as well as firms for which bank trading asset and liability data was not available.

This alternative would increase the number of entities able to avail themselves of the reduced compliance, documentation and metrics-reporting requirements, potentially resulting in cost reductions flowing through to customers and counterparties. At the same time, this alternative would permit greater risk-taking by entities affiliated with firms that have gross trading assets and liabilities in excess of $10 billion. In addition, it could encourage such firms to fragment their trading activity, for instance, across multiple dealers, and operate them "separately and independently," thereby relieving such firms of the requirement to comply with the hedging, compliance, and reporting regime of the 2013 final rule. This alternative may, therefore, reduce the regulatory oversight and compliance benefits of the full hedging, documentation, reporting, and compliance requirements for Group A banking entities. The feasibility and costs of such fragmentation would depend, in part, on organizational complexity of a firm's trading activity, the architecture of trading systems, the location and skillsets of personnel across various dealers affiliated with such entities, and current inter-affiliate hedging and risk mitigation practices.

b. Proprietary Trading

i. **Trading Account**

A. Costs and Benefits

Under the 2013 final rule, proprietary trading is defined as engaging as principal for the "trading account" of a banking entity.[317] Thus, the definition of the trading account effectively determines the trading activity that falls within the scope of the 2013 final rule prohibitions and the compliance regime associated with such activity. The current definition of trading account has three prongs, including the registered dealer prong. As discussed elsewhere in this

[317] *See* 2013 final rule § __.3(b).

Supplementary Information, the proposed amendments introduce certain changes to the trading account test. However, the proposal does not remove or modify the registered dealer prong. As a result, the proposed definition of "trading account" would continue to automatically include transactions in financial instruments by a registered dealer, swap dealer, or security-based swap dealer, if the purchase or sale is made in connection with the activity that requires the entity to be registered as such.[318] Thus, most (if not substantially all) trading activity by SEC-registered dealers should continue to be captured by the "trading account" of a banking entity, notwithstanding any of the changes made to the definition.

We recognize the possibility that some market participants may engage in transaction activity that does not trigger a dealer registration requirement. Under the baseline, such activity would be scoped into the "trading account" definition by the short-term prong and the rebuttable presumption by virtue of the fact that most transactions by a dealer are likely to be indicative of short-term intent as noted in the 2013 final rule.[319] We preliminarily believe that, under the proposal, such trading would likely be included in the trading account definition under the new prong on the basis of accounting treatment in reference to whether a financial instrument (as defined in the 2013 final rule and unchanged by the proposal) is recorded at fair value on a recurring basis under applicable accounting standards. In addition, persons engaging in the type and volume of activity that would be scoped in under the proposed accounting prong are likely engaged in the business of buying and selling securities for their own account as part of regular

[318] *See* 2013 final rule § __.3(b)(1)(iii).

[319] *See* 79 FR at 5549 ("The Agencies believe the scope of the dealer prong is appropriate because, as noted in the proposal, positions held by a registered dealer in connection with its dealing activity are generally held for sale to customers upon request or otherwise support the firm's trading activities (e.g., by hedging its dealing positions), which is indicative of short term intent.").

business, which would trigger broker-dealer (depending on the volume of activity) or SBSD registration requirements.

To the extent that the proposed amendments increase (or decrease) the scope of trading activity that falls under the proprietary trading prohibitions of the 2013 final rule, the amendments would increase (or decrease) the economic costs, benefits, and tradeoffs outlined in section V.D.1. However, we preliminarily believe that the largest share of dealing activity subject to SEC oversight is already captured by the registered dealer prong and that the economic effects of the proposed amendments to the definition of the trading account on SEC-registered entities may be de minimis. Therefore, we do not estimate any additional reporting costs for SEC registrants.

The Agencies also propose to include a reservation of authority allowing for determination, on a case-by-case basis, with appropriate notice and response procedures, that any purchase or sale of one or more financial instruments by a banking entity for which it is the primary financial regulatory agency either "is" or "is not" for the trading account. While the Agencies recognize that the use of objective factors to define proprietary trading is intended to provide bright lines that simplify compliance, the Agencies also recognize that this approach may, in some circumstances, produce results that are either underinclusive or overinclusive with respect to the definition of proprietary trading. The proposed reservation of authority may add uncertainty for banking entities about whether a particular transaction could be deemed as a proprietary trade by the regulating agency, which may affect the banking entity's decision to engage in transactions that are currently not included in the definition of the trading account. As

discussed in section V.B,[320] notice and response procedures related to the reservation of authority provision may cost as much as $20,319 for SEC-registered broker-dealers, and $5,006 for entities that may choose to register with the SEC as SBSDs.[321]

B. Alternatives

Specific Activities

The Agencies could have taken the approach of excluding specific trading activities from the scope of the proprietary trading prohibitions. For example, the Agencies could exclude transactions in derivatives on government securities, transactions in foreign sovereign debt and derivatives on foreign sovereign debt, and transactions executed by SEC-registered dealers on behalf of their asset management customers.

The 2013 final rule exempts all trading in domestic government obligations and trading in foreign government obligations under certain conditions; however, derivatives referencing such obligations–including derivatives portfolios that can replicate the payoffs and risks of such government obligations–are not exempted. Therefore, existing requirements reduce the flexibility of banking entities to engage in asset-liability management and treat two groups of

[320] For the purposes of the burden estimates in this release, we are assuming the cost of $409 per hour for an attorney, from SIFMA's "Management & Professional Earnings in the Securities Industry 2013," modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, and adjusted for inflation.

[321] We preliminarily believe that the burden reduction for SEC-regulated entities will be a fraction of the burden reduction for the holding company as a whole. We estimate the ratio on the basis of the fraction of total assets of broker-dealer affiliates of banking entities relative to the total consolidated assets of parent holding companies at approximately 0.18. To the extent that compliance burdens represent a fixed cost that does not scale with assets, or if the role and compliance burdens of entities that may register with the SEC as SBSDs may differ from those of broker-dealers, these figures may overestimate or underestimate compliance cost reductions for SEC-registered entities. Reporting burden for broker-dealers: 2 hours per firm per year x 0.18 weight x (Attorney at $409 per hour) x 138 firms = $20,319. Reporting burden for entities that may register as SBSDs: 2 hours per firm per year x 0.18 weight x (Attorney at $409 per hour) x 34 firms = $5,006.

financial instruments that have similar risks and payoffs differently. Excluding derivatives transactions on government obligations from the trading account definition could reduce costs to market participants and provide greater flexibility in their asset-liability management. This alternative could also result in increased volume of trading in markets for derivatives on government obligations, such as Treasury futures. We recognize, nonetheless, that derivatives portfolios that reference an obligation, including Treasuries, can be structured to magnify the economic exposure to fluctuations in the price of the reference obligation. Moreover, derivatives transactions involve counterparty credit risk not present in transactions in reference obligations themselves. Since the alternative would exclude all derivatives transactions on government obligations, and not just those that are intended to mitigate risk, this alternative could permit banking entities to increase their exposure to counterparty, interest rate, and liquidity risk.

Length of the Holding Period

In addition, the current registered dealer prong does not condition the trading account definition for registered dealers on the length of the holding period. This is because, as noted in the 2013 final rule, positions held by a registered dealer in connection with its dealing activity are generally held for sale to customers upon request or otherwise support the firm's trading activities (e.g., by hedging its dealing positions), which is indicative of short term intent.[322] As an alternative, the Agencies could have modified the registered dealer prong of the trading account definition to include only "near-term trading," e.g., positions held for less than 60, 90, or 120 days. This alternative would likely narrow the scope of application of the substantive proprietary trading prohibitions to a smaller portion of a banking entity's activities.

[322] 79 FR at 5549.

Under this alternative, dealers affiliated with banking entities would be able to amass large trading positions at the "near-term definition" boundary (e.g., for 61, 91, or 121 days) to take advantage of a directional market view, to profit from mispricing in an instrument, or to collect a liquidity premium in a particular instrument. This may significantly increase risk-taking and moral hazard in the activities of dealers affiliated with banking entities. However, as this alternative could stimulate an increase in potentially impermissible proprietary trading by these dealers, the volume of trading activity in certain instruments and liquidity in certain markets may increase.

We also note that the temporal thresholds necessary to implement such a "short-term" trading alternative would be difficult to quantify and may have to vary by product, asset class, and aggregate market conditions, among other factors. For instance, the markets for large cap equities and investment grade corporate bonds have different structures, types of participants, latency of trading, and liquidity levels. Therefore, an appropriate horizon for "short-term" positions will likely vary across these markets. Similarly, the ability to transact quickly differs under strong macroeconomic conditions and in times of stress. A meaningful implementation of this alternative would likely require calibrating and recalibrating complex thresholds to exempt non-near-term proprietary trading and so could introduce additional uncertainty and increase the compliance burdens on SEC-regulated banking entities.

"Trading Desk" Definition

The definition of "trading desk" is an important component of the implementation of the 2013 final rule in that certain requirements, such as those applicable to the underwriting and market-making exemptions, and the metrics-reporting requirements apply at the level of the trading desk. Under the current requirements, a trading desk is defined as the smallest discrete

unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof. The 2013 final rule recognizes that underwriting and market-making activities are essential financial services that facilitate capital formation and promote liquidity, and that metrics reporting may facilitate the SEC oversight of banking entities. The application of these rules at the trading desk level may facilitate monitoring and review of compliance with the underwriting and market-making exemptions and allow for better identification of the aggregate trading volume that must be reviewed for consistency with the underwriting, market making, and metrics-reporting requirements.

At the same time, some market participants have noted that the trading desk designation under the 2013 final rule may be unduly burdensome and costly and may have engendered inefficient fragmentation of trading activity. For example, some market participants report an average of 95 trading desks engaged in permitted activities.[323] Since under the 2013 final rule metrics reporting is required at the trading desk level, such fragmentation may result in operational inefficiencies and decentralized compliance programs, with some participants currently reporting as many as 5,000,000 data points per entity per filing.[324]

The Agencies are requesting comment on whether the trading desk definition should be amended to refer to a less granular "business unit" or a "unit designed to establish efficient trading for a market sector." This approach would allow a trading desk to be defined on the basis of the same criteria that are used to establish trading desks for other operational, management, and compliance purposes, which typically depend on the type of trading activity, asset class, product line offered, and individual banking entity structure and internal compliance

[323] *See supra* note 18.

[324] *See id.*

policies and procedures. For example, the Agencies could define the trading desk as a unit of organization of a banking entity that engages in purchasing or selling of financial instruments for the trading account of the banking entity or an affiliate thereof that is structured by a banking entity to establish efficient trading for a market sector, organized to ensure appropriate setting, monitoring, and review of trading and hedging limits, and characterized by a clearly defined unit of personnel. This would provide banking entities greater flexibility in determining their own optimal organizational structure and allow banking entities organized with various degrees of complexity to reflect their organizational structure in the trading desk definition. This alternative could reduce operational costs from fragmentation of trading activity and compliance program requirements, as well as enable more streamlined metrics reporting.

On the other hand, under this alternative, a banking entity may be able to aggregate impermissible proprietary trading with permissible activity (e.g., underwriting, market making, or hedging) into the same trading desk and consequently take speculative positions under the guise of permitted activities. To the extent that this alternative would allow banking entities to use a highly aggregated definition of a trading desk, it may increase moral hazard and the risks that the prohibitions of section 13 of the BHC Act aim to address. The SEC does not have data on operating and compliance costs because of the fragmentation incurred by SEC-regulated banking entities, or data on the organizational complexity of such dealers, and the extent of variation therein.

ii. **Liquidity Management Exclusion**

Liquidity management serves an important purpose in ensuring banking entities have sufficient resources to meet their short-term operational needs. Under the 2013 final rule, certain activities related to liquidity management are excluded from the scope of the proprietary trading

prohibition under some conditions.[325] The current exclusion covers any purchase or sale of a security by a banking entity for the purpose of liquidity management in accordance with a documented liquidity management plan that meets a number of requirements. Moreover, current rules require that the financial instruments purchased and sold as part of a liquidity management plan be highly liquid and not reasonably expected to give rise to appreciable profits or losses as a result of short-term price movements.

The Agencies recognize that the liquidity management exclusion may be narrow and that the trading account definition may scope in routine asset-liability management and commercial-banking related activities that trigger the rebuttable presumption or the market-risk capital prong. Accordingly, the Agencies are proposing to expand the liquidity management exclusion. Specifically, the proposed amendments would broaden the liquidity management exclusion such that it would apply not only to securities, but also to foreign exchange forwards and foreign exchange swaps (as defined in the Commodity Exchange Act), and to physically settled cross-currency swaps.

Under the proposed amendment, SEC-regulated banking entities would face lower burdens and enjoy greater flexibility in currency-risk management as part of their overall liquidity management plans. To the degree that the 2013 final rule may be restricting liquidity-risk management by banking entities, and to the extent that these effects impact their trading activity, the proposed amendment could facilitate more efficient risk management, greater secondary market activity, and more capital formation in primary markets. However, in the absence of other conditions governing reliance on the liquidity management exclusion, this flexibility may also lead to currency derivatives exposures, including potentially very large

[325] *See* 2013 final rule § __.3(d)(3).

exposures, being scoped out of the trading account definition and the ensuing substantive prohibitions of the 2013 final rule. In addition, some entities may seek to rely on this exclusion while engaging in speculative currency trading, which may increase their risk-taking and moral hazard and reduce the effectiveness of regulatory oversight. While the proposed amendment broadens the set of instruments that banking entities may use to manage liquidity, the proposed reservation of authority would provide the Agencies with the ability to determine whether a particular purchase or sale of a financial instrument by a banking entity either is or is not for the trading account.

iii. **Error trades**

The 2013 final rule excludes from the proprietary trading prohibition certain "clearing activities" by banking entities that are members of clearing agencies, derivatives clearing organizations, or designated financial market utilities. Specifically, such clearing activities are defined to include, among others, any purchase or sale necessary to correct error trades made by, or on behalf of, customers with respect to customer transactions that are cleared, provided the purchase or sale is conducted in accordance with certain regulations, rules, or procedures. However, the current exclusion for error trades is applicable only to clearing members with respect to cleared customer transactions.[326]

The proposed amendments would exclude trading errors and subsequent correcting transactions from the definition of proprietary trading. The proposed amendments primarily impact SEC-registered dealers that are not clearing members with respect to all customer trades and dealers that are clearing members with respect to customer trades that are not cleared. Table

[326] *See* 2013 final rule § __.3(e)(7).

6 reports information about broker-dealer count, assets, and holdings, by affiliation and clearing type.

Table 6. Broker-dealer assets and holdings by clearing status.[327]

Broker-dealers subject to section 13 of the BHC Act	#	Total assets, $mln	Holdings, $mln	Holdings (altern.), $mln
Clear / carry	56	3,002,341	720,863	533,100
Other	82	36,996	3,843	3,455
Total	138	3,039,337	724,706	536,555

Since correcting error trades by or on behalf of customers is not conducted for the purpose of profiting from short-term price movements, this amendment is likely to facilitate valuable customer-facing activities. As discussed elsewhere in this Supplementary Information, the Agencies believe that banking entities should monitor and manage their error trade account because doing so would help prevent personnel from using these accounts for the purpose of evading the 2013 final rule. We preliminarily believe that existing requirements and SEC oversight would be sufficient to deter participants from using the error trade exclusion to obfuscate impermissible proprietary trades.

c. Permitted Underwriting and Market Making

i. **Regulatory Baseline**

Underwriting and market making are customer-oriented financial services that are essential to capital formation and market liquidity, and the risks and profit sources related to

[327] Broker-dealers clearing and / or carrying customer accounts are identified using FOCUS filings. Broadly, broker-dealers that are clearing or carrying firms directly carry customer accounts, maintain custody of the assets, and clear trades. Other broker-dealers may accept customer orders but do not maintain custody of assets. *See, e.g.,* Clearing Firms FAQ, FINRA, https://www.finra.org/arbitration-and-mediation/faq-clearing-firms-faq. This analysis excludes SEC-registered broker-dealers affiliated with banks that have consolidated total assets less than or equal to $10 billion and trading assets and liabilities less than or equal to 5% of total assets, as well as firms for which bank trading asset and liability data was not available.

these activities are distinct from those related to impermissible proprietary trading. Therefore, the 2013 final rule contains exemptions for underwriting and market making-related activities.

Under the 2013 final rule, all banking entities with covered activities must satisfy five requirements with respect to their underwriting activities to qualify for the underwriting exemption.[328] First, the banking entity must act as an underwriter for a distribution of securities, and the trading desk's underwriting position must be related to such distribution.[329] Second, the amount and type of the securities in the trading desk's underwriting position must be designed not to exceed RENTD, and reasonable efforts must 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.[330] Third, the banking entity must establish and implement, maintain, and enforce an internal compliance system that is reasonably designed to ensure the banking entity's compliance with the requirements. The compliance program must include the list of the products, instruments, or exposures each trading desk may purchase, sell, or manage as part of its underwriting activities, as well as the limits for each trading desk, based on the nature and amount of the trading desk's underwriting activities, including RENTD limits.[331] Fourth, the compensation arrangements of persons engaged in underwriting must be designed to not reward or incentivize prohibited proprietary trading.[332] Fifth, the banking entity must be appropriately licensed or registered to perform underwriting activities.[333]

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[328] *See* 2013 final rule § __.4 (a).

[329] *See* 2013 final rule § __.4 (a)(2)(i).

[330] *See* 2013 final rule § __.4 (a)(2)(ii).

[331] *See* 2013 final rule § __.4 (a)(2)(iii).

[332] *See* 2013 final rule § __.4 (a)(2)(iv).

[333] *See* 2013 final rule § __.4 (a)(2)(v).

Under the current baseline, all banking entities with covered activities must satisfy six requirements with respect to their market-making activities to qualify for the market-making exemption.[334] First, the trading desk responsible for the market-making activities must routinely stand ready to purchase and sell the financial instruments in which it is making markets and must be willing and available to quote, purchase, and sell, or otherwise enter into long and short positions in these types of financial instruments for its own account in commercially reasonable amounts and throughout market cycles.[335] Second, the trading desks' market-maker inventory must be designed not to exceed, on an ongoing basis, RENTD.[336] Third, the banking entity must establish, implement, and enforce an internal compliance program, reasonably designed to ensure compliance with the requirements. This compliance program must include, among other things, limits for each trading desk that address RENTD.[337] Fourth, the banking entity must ensure that any violations of risk limits are promptly corrected. Fifth, the compensation arrangements of persons engaged in market making must be designed so as to not reward or incentivize prohibited proprietary trading. Finally, the banking entity must be appropriately licensed or registered.

We also note that, under the baseline, an organizational unit or a trading desk of another banking entity that has consolidated trading assets and liabilities of $50 billion or more is generally not considered a client, customer, or counterparty for the purposes of the RENTD requirement.[338] Thus, such demand does not contribute to RENTD unless such demand is

[334] *See* 2013 final rule § __.4 (b).

[335] *See* 2013 final rule § __.4 (b)(2)(i).

[336] *See* 2013 final rule § __.4 (b)(2)(ii).

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

[338] *See* 2013 final rule § __.4 (b)(3)(i).

affected through an anonymous trading facility or unless the trading desk documents how and why the organizational unit of said large banking entity should be treated as a client, customer, or counterparty. To the extent that such documentation requirements increase the cost of intermediating interdealer transactions, this current requirement may impact the volume and cost of interdealer trading.

The Agencies understand that current compliance with the RENTD requirements under both the underwriting and market-making exemptions creates ambiguity for some market participants, is over-reliant on historical demand, and necessitates an accurate calibration of RENTD for different asset classes, time periods, and market conditions.[339] Since forecasting future customer demand involves uncertainty, particularly in less liquid and more volatile instruments and products, banking entity affiliated dealers may face uncertainty about the ability to rely on the underwriting and market-making exemptions. This uncertainty can reduce a banking entity's willingness to engage in principal transactions with customers,[340] which, along with reducing profits, can adversely impact the volume of transactions intermediated by banking

[339] *See supra* note 18.

[340] For instance, Bessembinder et al. (2017) shows that dealers have shrunk their intraday capital commitment, measured as the absolute difference between their daily accumulated buy volume and sell volume. Similarly, the FRB's "Staff Q2 2017 Report on Corporate Bond Market Liquidity" (available at https://www.federalreserve.gov/foia/files/bond-market-liquidity-report-2017Q2.pdf) shows a steep decline in broker-dealer holdings of corporate and foreign bonds between 2007 and 2009 and a gradual decline in 2012 onwards.

While some research suggests the decline in dealer inventories is attributable to the 2013 final rule (e.g., Bessembinder et al. (2017)), other studies show that inventory declines in fixed income markets occurred in the immediate aftermath of the financial crisis and coincided with a drastic decline in profitability of trading desks during the crisis (e.g., Access to Capital and Market Liquidity, *supra* note 106, Figure 34). It is difficult to clearly distinguish the causal effects of the various provisions of section 13 of the BHC Act from the influence of other confounding factors, such as crisis-related changes in dealer risk aversion and declines in profitability of trading, macroeconomic conditions, the evolution of market structure and new technology, and other factors.

entities. To the extent that non-banking entities do not step in to intermediate trades that do not occur as a result of the RENTD requirement,[341] and to the extent that technological advances do not allow customers to trade against other customers,[342] thereby shortening dealer intermediation chains, counterparties of affected banking entities may have difficulty transacting in some market segments.[343]

ii. **Costs and Benefits**

Under the proposal, Group A and Group B entities with covered activities would be presumed compliant with the RENTD requirements of the underwriting and market-making exemptions if the banking entity establishes and implements, maintains, and enforces internally set risk limits. These risk limits would be subject to regulatory review and oversight on an ongoing basis, which would include an assessment of whether the limits are designed not to exceed RENTD. For Group A entities, these limits are required to be established within the entity's compliance program. Under the proposed amendment, Group B entities would not be required to establish a separate compliance program for underwriting and market-making requirements, including the risk limits for RENTD. However, in order to be presumed compliant with the underwriting and market-making exemptions, Group B entities must establish and comply with the RENTD limits. We note that Group B entities seeking to rely on the presumption of compliance would still be required to comply with the RENTD requirements,

[341] *See supra* note 290.

[342] *See, e.g.,* Access to Capital and Market Liquidity *supra* note 106, Part IV.C.4 (describing corporate bond activity on electronic venues).

[343] We are not aware of any data that allows us to quantify the impacts of individual provisions of section 13 of the BHC Act on dealer inventories or market liquidity. The evidence on the impacts of section 13 on various measures of corporate bond, credit default swap (CDS), and bond fund liquidity is sensitive to the choice of market, measure, time period, and empirical methodology. For a literature review, *see, e.g.,* Access to Capital and Market Liquidity *supra* note 106.

even though they would not be required to design a specific underwriting or market-making compliance program. Under the proposed amendments, Group C banking entities would be presumed compliant with requirements of subpart B and subpart C of the rule, including with respect to the reliance on the underwriting and market-making exemptions, without reference to their internal RENTD limits. In addition, under the proposal, Group A entities relying on internal risk limits for market-making RENTD requirements must promptly reduce the risk exposure when the risk limit is exceeded.

The proposed amendments may provide SEC-registered banking entities with more flexibility and certainty in conducting permissible underwriting and market making-related activities. The proposed presumption allows the reliance on internally-set risk limits in accordance with a banking entity's risk management function that may already be used to meet other regulatory requirements, such as obligations under the SEC and FINRA capital and liquidity rules,[344] so long as these limits meet the requirements under the proposed amendment. Therefore, the proposed amendment may prevent unnecessary duplication of risk-management compliance procedures for the purposes of complying with multiple regulations and may reduce compliance costs for SEC-regulated banking entities. To the extent that the uncertainty and compliance burdens related to the RENTD requirements are currently impeding otherwise profitable permissible underwriting and market making by dealers, the proposed amendments may increase banking entities' profits and the volume of dealer intermediation.

The proposed regulatory oversight of the internally-set risk limits may result in new compliance burdens for SEC registrants, potentially offsetting the cost-reducing effects of other proposed amendments to the compliance with the underwriting and market-making exemptions.

[344] *See, e.g.,* 17 CFR 240.15c3-1.

However, if banking entities are permitted to rely on internal risk limits to meet the RENTD requirement, Agency oversight of internal risk limits for the purposes of compliance with the proposed rule may help support the benefits and costs of the substantive prohibitions of section 13 of the BHC Act. Additionally, the costs of the prompt notice requirement for exceeding the risk limits will depend on a given entity's trading activity and on its design of internal risk limits, which are likely to reflect, among other factors, the entity's respective business model, organizational structure, profitability and volume of trading activity. As a result, we cannot estimate these costs with any degree of certainty.

The overall economic effect of these amendments will depend on the amount and profitability of economic activity that currently does not occur because of the uncertainty surrounding the RENTD requirement compared to the potential costs of establishing and maintaining internal risk limits, and uncertainty related to validation that these limits would meet the requirements under the proposed amendments. We do not have data on the volume of trading activity that does not occur because of uncertainty and costs surrounding the RENTD requirement, or data on the profitability of such trading activity for banking entities. To the best of our knowledge, no such data is publicly available.

To the extent that internal risk limits may be designed to exceed the actual RENTD, introducing the proposed presumption may also increase risk-taking by banking entity dealers. As a result, under the proposed amendments, some entities may be able to maintain positions that are larger than RENTD and, thus, increase their risk-taking. This type of activity could increase moral hazard and reduce the economic effects of section 13 of the BHC Act and the implementing rules. However, to mitigate this effect, the Agencies are proposing that the internally set risk limits that would be used to establish the presumption of compliance would be

subject to ongoing regulatory assessments as to whether they are designed not to exceed RENTD.

We note that the proposed amendments tailor regulatory relief for smaller banking entities for both the underwriting and market-making exemptions. More specifically, the threshold for the reduced requirements is based on trading assets and liabilities for both exemptions. We also recognize that the nature, profit sources, and risks of underwriting and market-making activities differ. For example, underwriting may involve pricing, book building, and placement of securities with investors, whereas market making centers on intermediation of trading activity.

In that regard, the Agencies could have proposed an approach, under which underwriting and market-making requirements are tailored to banking entities on the basis of different thresholds. For example, the Agencies could have instead relied on the trading assets and liabilities threshold for market-making compliance (as proposed), but applied a different threshold for underwriting compliance, on the basis of the volume or profitability of past underwriting activity. This alternative would have tailored the compliance requirements for SEC-regulated banking entities with respect to underwriting activities. However, the volume and profitability of underwriting activity is highly cyclical and is likely to decline in weak macroeconomic conditions. As a result, under the alternative, SEC-regulated banking entities would face lower compliance obligations with respect to underwriting activity during times of economic stress when covered trading activity related to underwriting may pose the highest risk of loss.

iii. **Efficiency, Competition, and Capital Formation**

As discussed above, these proposed amendments may reduce the costs of relying on the underwriting and market-making exemptions, which may facilitate the activities related to these

exemptions. The evolution in market structure in some asset classes (e.g., equities) has transformed the role of traditional dealers vis-à-vis other participants, particularly as it relates to high-frequency trading and electronic platforms. However, dealers continue to play a central role in less liquid markets, such as corporate bond and over-the-counter derivatives markets. While it is difficult to establish causality, corporate bond dealers, particularly bank-affiliated dealers, have, on aggregate, significantly reduced their capital commitment post-crisis—a finding that is consistent with a reduction in liquidity provision in corporate bonds due to the 2013 final rule.[345] In addition, corporate bond dealers may have shifted from trading in a principal capacity to agency trading.[346] To the extent that this change cannot be explained by enhanced ability of dealers to manage corporate bond inventory, electronic trading, post-crisis changes in dealer risk tolerance and macro factors (effects which themselves need not be fully independent of the effect of section 13 of the BHC Act and the 2013 final rule), such effects may point to a reduced supply of liquidity by dealers. Moreover, corporate bond dealers decrease liquidity provision in times of stress in general (e.g., during a financial crisis)[347] and after the 2013 final rule in particular (under a few isolated stressed selling conditions, some evidence shows greater price impact from trading activity).[348] In dealer-centric single-name CDS markets,

[345] *See, e.g.,* Staff Q2 2017 Report on Corporate Bond Market Liquidity *supra* note 340; *see also* Bessembinder et al. (2017).

[346] Dealers can trade as agents, matching customer buys to customer sells, or as principals, absorbing customer buys and customer sells into inventory and committing the necessary capital.

[347] Dealers provide less liquidity to clients and peripheral dealers during stress times; during the peak of the crisis core dealers charged higher spreads to peripheral dealers and clients but lower spreads to dealers with whom they had strong ties. *See* Di Maggio, Kermani, and Song, 2017, "The Value of Trading Relationships in Turbulent Times." Journal of Financial Economics 124(2), 266-284; *see also* Choi and Shachar, 2013, "Did Liquidity Providers Become Liquidity Seekers?" New York Fed Staff Report No. 650, *available at* https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr650.pdf.

[348] *See* Bao et al. (2017); Anderson and Stulz (2017).

interdealer trade activity, trade sizes, quoting activity, and quoted spreads for illiquid underliers have deteriorated since 2010, but dealer-customer activity and various trading activity metrics have remained stable.[349]

Because of the methodological challenges described earlier in this analysis, we cannot quantify potential effects of the 2013 final rule in general, and the RENTD, underwriting, and market-making provisions of the 2013 final rule in particular, on capital formation and market liquidity. We also recognize that these provisions may not be currently affecting all securities markets, asset classes, and products uniformly. If, because of uncertainty and the costs of relying on market-making and hedging exemptions, dealers are limiting their market-making and hedging activity in certain products, the proposed amendments may facilitate market making. Because secondary market liquidity can influence the willingness to invest in primary markets, and access to these markets can enable market participants to mitigate undesirable risk exposures, the amendments may increase trading activity and capital formation in some segments of the market.

While the statute and the 2013 final rule, including as proposed to be amended, prohibit banking entities from engaging in proprietary trading, some trading desks may attempt to use certain elements of the proposed RENTD amendments to circumvent those restrictions. This may reduce the economic benefits and costs of the 2013 final rule outlined in section V.D.1. We continue to recognize that proprietary trading by banking entities may give rise to moral hazard, economic inefficiency because of implicitly subsidized risk-taking, and market fragility, and may increase conflicts of interest between banking entities and their customers. An analysis of the effects of the 2013 final rule in general, and the specific amendments being proposed here in

[349] For a literature review and data, see Access to Capital and Market Liquidity *supra* note 106.

particular, on moral hazard, risk-taking, systemic risk, and conflicts of interest described above, faces the same methodological challenges discussed in section V.D.1. and in this section. In addition, existing qualitative analysis and quantitative estimates of moral hazard, risk-taking incentives resulting from deposit insurance and implicit bailout guarantees, and systemic risk implications of proprietary trading, centers on banking entities that are not SEC registrants.[350] However, we continue to recognize that the effects of the proposed amendments on bank entity risk-taking and conflicts of interest may flow through to SEC-registered dealers and investment advisers affiliated with banks and bank holding companies and may impact securities markets. As suggested by academic evidence, the presence and magnitude of spillovers across different types of financial institutions vary over time and may be more significant in times of stress.[351]

[350] For a literature review, *see, e.g.*, Benoit et al. (2017). Some examples include:

- A large proportion of the variation in bank market-to-book ratios over time may be due to changes in the value of government guarantees. *See* Atkeson et al. (2018).
- Moral hazard resulting from idiosyncratic and targeted bailouts may make the economy significantly more exposed to financial crises, while moral hazard effects may be limited if bailouts are systemic and broad based. *See* Bianchi (2016); *see also* Kelly et al. (2016).
- Deposit insurance and financial safety nets increased bank risk-taking and measures of systemic fragility in the run-up to the global financial crisis. However, during the crisis itself, deposit insurance reduced bank risk and systemic stability. *See* Anginer et al. (2014).
- Short-term capital market funding may increase bank fragility. *See* Beltratti and Stulz (2012).
- Implicit bailout guarantees for the financial sector as a whole are priced in spreads on index put options far more than those on put options of individual banks. *See*, *e.g.*, Kelly et al. (2016).
- Other research used CDS data to measure the value of government bailouts to bondholders and stockholders of large financial firms during the global financial crisis. *See* Veronesi and Zingales (2010).

[351] *See, e.g.*, Billio, Getmansky, Lo, and Pelizzon, 2012, Econometric Measures of Connectedness and Systemic Risk in the Finance and Insurance Sectors, Journal of Financial Economics 104(3), 535-559; *see also* Alam, Fuss, and Gropp, 2014, Spillover Effects Among Financial Institutions: A State-Dependent Sensitivity Value at Risk Approach (SDSVar). Journal

Where the proposed amendments increase the scope of permissible activities or decrease the risk of detection of proprietary trading, their impact on informational efficiency stems from a balance of two effects. On the one hand, where banking entities' proprietary trading strategies are based on superior analysis and prediction models, their reduced ability to trade on such information may make securities markets less informationally efficient. While such proprietary trading strategies can be executed by broker-dealers unaffiliated with banking entities and unaffected by the prohibitions on proprietary trading, their ability to do so may be constrained by their limited access to capital and a lack of scale needed to profit from such strategies. On the other hand, if superior information is obtained by an entity from its customer-facing activities and as a result of conflicts of interest, proprietary trading may make customers less willing to transact with banks or participate in securities markets.

iv. **Loan-Related Swaps**

The Agencies are requesting comment on the treatment of swaps entered into with a customer in connection with a loan provided to the customer. Specifically, loan-related swaps are transactions between a banking entity and a loan customer that are directly related to the terms of the customer's loan. The Agencies understand that such swaps may be considered financial instruments triggering proprietary trading prohibitions of the 2013 final rule. As a result, a banking entity would need to rely on an applicable exclusion from the definition of proprietary trading or an exemption in the implementing regulations in order for this activity to be permissible.

Accordingly, the Agencies are requesting comment on whether loan-related swaps should be permitted under the market-making exemption if the banking entity stands ready to make a market in both directions whenever a customer makes an appropriate request, but in practice

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of Financial and Quantitative Analysis 49(3), 575-598; Adrian and Brunnermeier, 2016, CoVar, American Economic Review 106(7), 1705-1741.

primarily makes a market in the swaps only in one direction. The Agencies are also requesting comment on whether it would be appropriate to exclude loan-related swaps from the definition of proprietary trading for some banking entities or to permit the activity pursuant to an exemption from the prohibition on proprietary trading other than market making.

Addressing the treatment of loan-related swaps may benefit banking entities that are currently unsure as to their ability to engage in loan-related swaps pursuant to the existing market-making exemption. Legal certainty in this space may increase the willingness of banking entities to accommodate customer demand for such loans and increase certainty that such activity would not trigger the proprietary trading prohibition. To the degree that the back-to-back offsetting purchases and sales of derivatives are not immediate, and to the extent that such transactions are not cleared and involve counterparty risk, this may also increase risk-taking by banking entities. To the extent that the proposed guidance was to increase the scope of permissible proprietary trading activity, such activity would implicate the economic tradeoffs of the proprietary trading prohibitions of the 2013 final rule discussed in section V.D.1.

d. Permitted Risk-Mitigating Hedging

i. **Regulatory Baseline**

Under the baseline, certain risk-mitigating hedging activities may be exempt from the restriction on proprietary trading under the risk-mitigating hedging exemption. To make use of this exemption, the 2013 final rule requires all banking entities to comply with a comprehensive and multi-faceted set of requirements, including: (1) the establishment and implementation, and maintenance of an internal compliance program; (2) satisfaction of various criteria for hedging activities; and (3) the existence of compensation arrangements for persons performing risk-mitigating hedging activities that are designed not to reward or incentivize prohibited proprietary

trading. In addition, certain activities under the hedging exemption are subject to documentation requirements.[352]

Specifically, 2013 final rule requires that a banking entity seeking to rely on the risk-mitigating hedging exemption must establish, implement, maintain, and enforce an internal compliance program that is reasonably designed to ensure compliance with the requirements of the rule. Such a compliance program must include reasonably designed written policies and procedures regarding the positions, techniques, and strategies that may be used for hedging, including documentation indicating what positions, contracts, or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts, or other holdings. The compliance program also must provide for internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures. In addition, the 2013 final rule requires that all banking entities, as part of their compliance program, must conduct analysis, including correlation analysis, and independent testing designed to ensure that the positions, techniques, and strategies that may be used for hedging are designed to reduce or otherwise significantly mitigate and demonstrably reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged.

The 2013 final rule does not require a banking entity to prove correlation mathematically—rather, the nature and extent of the correlation analysis should be dependent on the facts and circumstances of the hedge and the underlying risks targeted. Moreover, if correlation cannot be demonstrated, the analysis needs to state the reason and explain how the proposed hedging position, technique, or strategy is designed to reduce or significantly mitigate

[352] *See* 2013 final rule § __.5.

risk and how that reduction or mitigation can be demonstrated without correlation.[353] Some market participants have argued that the inability to perform correlation analysis, for instance, for non-trading assets such as mortgage servicing assets, can add as much as 2% of the asset value to the cost of hedging.[354]

To qualify for the risk-mitigating hedging exemption, the hedging activity, both at inception and at the time of any adjustment to the hedging activity, must be designed to reduce or otherwise significantly mitigate and demonstrably reduce or significantly mitigate one or more specific identifiable risks.[355] Hedging activities also must not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously. Additionally, the hedging activity must be subject to continuing review, monitoring, and management by the banking entity, including ongoing recalibration of the hedging activity to ensure that the hedging activity satisfies the requirements for the exemption and does not constitute prohibited proprietary trading. Lastly, the compensation arrangements of persons performing risk-mitigating hedging activities must be designed so as to not reward or incentivize prohibited proprietary trading.

Finally, the 2013 final rule requires banking entities to document and retain information related to the purchase or sale of hedging instruments that are either (1) established by a trading desk that is different from the trading desk establishing or responsible for the risks being hedged; (2) established by the specific trading desk establishing or responsible for the risks being hedged but that are effected through means not specifically identified in the trading desks written

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[353] *See* 79 FR at 5631.

[354] *See supra* note 18.

[355] *See* 2013 final rule § __.5(b)(2)(ii).

policies and procedures; or (3) established to hedge aggregate positions across two or more trading desks.[356] The documentation must include the specific identifiable risks being hedged, the specific risk-mitigating strategy that is being implemented, and the trading desk that is establishing and responsible for the hedge. These records must be retained for a period of not less than 5 years in a form that allows them to be promptly produced if requested.[357]

As discussed elsewhere in this Supplementary Information, the Agencies recognize that, in some circumstances, it may be difficult to know with sufficient certainty whether a potential hedging activity will continue to demonstrably reduce or significantly mitigate an identifiable risk after it is implemented. Unforeseeable changes in market conditions and other factors could reduce or eliminate the intended risk-mitigating impact of the hedging activity, making it difficult for a banking entity to comply with the continuous requirement that the hedging activity demonstrably reduce or significantly mitigate specific, identifiable risks. In such cases, a banking entity may choose not to enter into a hedge out of concern that it may not be able to effectively comply with the continuing requirement to demonstrate risk mitigation.

We also recognize that SEC-regulated entities may engage in both static and dynamic hedging at the portfolio (and not at the transaction) level and monitor and reevaluate aggregate portfolio risk exposures on an ongoing basis, rather than the risk exposure of individual transactions. Dynamic hedging may be particularly common among dealers with large derivative portfolios, especially when the values of these portfolios are nonlinear functions of the prices of the underlying assets (e.g., gamma hedging of options). The rules currently in effect permit dynamic hedging, but require the banking entity to document and support its decisions

[356] *See* 2013 final rule § __.5(c)(1).

[357] *See* 2013 final rule § __.5(c)(3); *see also* 2013 final rule § __.20(b)(6).

regarding individual hedging transactions, strategies, and techniques for ongoing activity in the same manner as for its initial activities, rather than the hedging decisions regarding a portfolio as a whole.

ii. **Costs and Benefits**

As discussed elsewhere in this Supplementary Information, the Agencies recognize that hedging is an essential tool for risk mitigation and can enhance a banking entity's provision of client-facing services, such as market making and underwriting, as well as facilitate financial stability. In recognition of the role that this activity plays as part of a banking entity's overall operations, the Agencies have proposed a number of changes that are intended to streamline and clarify the current exemption for risk-mitigating hedging activities.

The first proposed amendment concerns the "demonstrability" requirement of the risk-mitigating hedging exemption. Specifically, the Agencies propose to eliminate the requirement that the risk-mitigating hedging activity must demonstrably reduce or otherwise significantly mitigate one or more specific identifiable risks at the inception of the hedge. Additionally, the demonstrability requirement would also be removed from the requirement to continually review, monitor, and manage the banking entity's existing hedging activity. We also note that banking entities would continue to be subject to the requirement that the risk-mitigating hedging activity be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, as well as to the requirement that the hedging activity be subject to continuing review, monitoring and management by the banking entity to confirm that such activity is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging.

The removal of the demonstrability requirement is expected to benefit banking entity dealers, as it would decrease uncertainty about the ability to rely on the risk-mitigating hedging exemption and may reduce the compliance costs of engaging in permitted hedging activities. While this aspect of the proposal may alleviate compliance burdens related to risk management and potentially facilitate greater trading activity and liquidity provision by bank-affiliated dealers, it could also enable dealers to accumulate large proprietary positions through adjustments (or lack thereof) to otherwise permissible hedging portfolios. Therefore, we recognize that the proposed amendment could increase moral hazard risks related to proprietary trading by allowing dealers to take positions that are economically equivalent to positions they could have taken in the absence of the 2013 final rule.

The second proposed amendment to the risk-mitigating hedging exemption is the removal of the requirement to perform the correlation analysis. The Agencies recognize that a correlation analysis based on returns may be prohibitively complex for some asset classes, and that a correlation coefficient may not always serve as a meaningful or predictive risk metric. While we recognize that, in some instances, correlation analysis of past returns may be helpful in evaluating whether a hedging transaction was effective in offsetting the risks intended to be mitigated, correlation analysis may not be an effective tool for such evaluation in other instances. For example, correlation across assets and asset classes evolves over time and may exhibit jumps at times of idiosyncratic or systematic stress. Additionally, the hedging activity, even if properly designed to reduce risk, may not be practicable if costly delays or compliance complexities result from a requirement to undertake a correlation analysis. Thus, the removal of the correlation analysis requirement may provide dealers with greater flexibility in selecting and executing risk-mitigating hedging activities. However, we also recognize that the removal of the correlation

analysis requirement may result in tradeoffs discussed above. To the extent that some banking entities may be able to engage in speculative proprietary trading activities while relying on the risk-mitigating hedging exemption, the proposed amendment may potentially increase moral hazard and conflicts of interest between banking entities and their customers, notwithstanding the fact that a potential increase in permitted risk-mitigating hedging may increase capital formation and trading activity by banking entities.

The third proposed amendment simplifies the requirements of the risk-mitigating hedging exemption for Group B banking entities (i.e., those with moderate trading assets and liabilities). The proposed amendment would remove the requirement to have a specific risk-mitigating hedging compliance program, as well as the documentation requirements and certain hedging activity requirements for Group B entities.[358] As a result, these dealers would be subject to two key hedging activity requirements: (1) that a hedging transaction must be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks; and (2) that a hedging transaction is subject, as appropriate, to ongoing review, monitoring, and management by the banking entity that requires recalibration of the hedging activity to ensure that the hedging activity satisfies the requirements on an ongoing basis and is not prohibited proprietary trading. Under the proposed amendments, Group C banking entities are presumed compliant with subpart B and subpart C of the proposed rule, including with respect to the reliance on the hedging exemption.

As discussed elsewhere in this Supplementary Information, the Agencies recognize that banking entities without significant trading assets and liabilities are less likely to engage in large and/or complicated trading activities and hedging strategies. We continue to recognize that

[358] Group C banking entities (i.e., those with limited trading assets and liabilities) also would not be subject to these express requirements.

compliance with the 2013 final rule may impose disproportionate costs on banking entities without significant trading assets and liabilities. Therefore, the proposed amendment would benefit Group B and Group C entities, as it would reduce the costs of relying on the hedging exemption and, thus, engaging in hedging activities. To the extent that the removal of these requirements may reduce the costs of risk-mitigating hedging activity, Group B and Group C entities may increase their intermediation activity while also growing their trading assets and liabilities.

The fourth proposed amendment reduces documentation requirements for Group A entities. In particular, the proposal removes the documentation requirements for some financial instruments used for hedging. More specifically, the instrument would not be subject to the documentation requirement if: (1) it is identified on a written list of pre-approved financial instruments commonly used by the trading desk for the specific type of hedging activity; and (2) at the time the financial instrument is purchased or sold the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The SEC lacks information or data that would allow us to quantify the magnitude of the expected cost reductions, as the prevalence of hedging activities depends on each registrant's organizational structure, business model, and complexity of risk exposures. However, the SEC preliminarily believes that the flexibility to choose between providing documentation regarding risk-mitigating hedging transactions and establishing hedging limits for pre-approved instruments may be beneficial for Group A entities, as it will allow these entities to tailor their compliance regime to their specific organizational structure and existing policies and procedures. Finally, in section V.B, the Agencies estimate

burden reductions per firm from the proposed amendments. The proposed amendments to § __.5(c) will result in ongoing cost savings estimated at $203,191 for SEC-registered broker-dealers.[359] Additionally, the proposed amendments will result in lower ongoing costs for potential SBSD registrants relative to the costs that they would incur under the current regime if they were to choose to register with the SEC – this cost reduction is estimated to reach up to $50,062.[360] However, we recognize that compliance with SBSD registration requirements is not yet required and that there are currently no registered SBSDs. Similarly, the proposed amendments may also reduce initial set-up costs related to § __.5(c) by $101,596 for SEC-registered broker-dealers and up to $25,031 for entities that may choose to register with the SEC as SBSDs.[361]

The proposed hedging amendment eliminates all hedging-specific compliance program requirements including correlation analysis, documentation requirements, and some hedging activity requirements for Group B entities. The proposed amendments eliminate only some of the compliance program requirements for Group A entities and provide a documentation requirement exemption for some hedging activity of these entities. Since the fixed costs of relying on such exemptions may be more significant for entities with smaller trading books, the

[359] Recordkeeping burden reduction for broker-dealers: 20 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 138 firms = $203,191. Recordkeeping burden reduction for entities that may register as SBSDs: 20 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 34 firms = $50,062.

[360] Recordkeeping burden reduction for entities that may register as SBSDs: 20 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 34 firms = $50,062.

[361] Initial set-up burden reduction for broker-dealers: 10 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 138 firms = $101,596. Initial set-up burden reduction for entities that may register as SBSDs: 10 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 34 firms = $25,031.

proposed hedging amendment may permit Group B entities just below the $10 billion threshold to more effectively compete with Group A entities just above the threshold.

The proposed hedging amendments may also impact the volume of hedging activity and capital formation. To the extent that some registrants currently experience significant compliance costs related to the hedging exemption, these costs may constrain the amount of risk-mitigating hedging they currently engage in. The ability to hedge underlying risks at a low cost can facilitate the willingness of SEC-regulated entities to commit capital and take on underlying risk exposures. Because the proposed amendments would reduce costs of relying on the hedging exemption, these entities may become more incentivized to engage in risk-mitigating hedging activity, which may in turn contribute to greater capital formation.

e. Trading Outside the United States

i. **Baseline**

Under the 2013 final rule, a foreign banking entity that has a branch, agency, or subsidiary located in the United States (and is not itself located in the United States) is subject to the proprietary trading prohibitions and related compliance requirements unless it meets five criteria.[362] First, a branch, agency, or subsidiary of a foreign banking organization that is located in the United States or organized under the laws of the United States or of any state may not engage as principal in the purchase or sale of financial instruments (including any personnel that arrange, negotiate, or execute a purchase or sale). Second, the banking entity (including relevant personnel) that makes the decision to engage in the transaction must not be located in the United States or organized under the laws of the United States or of any state. Third, the transaction, including any transaction arising from risk-mitigating hedging related to the transaction, must not be accounted for as principal directly or on a consolidated basis by any branch or affiliate

[362] *See* 2013 final rule § __.6(e).

that is located in the United States or organized under the laws of the United States or of any state. Fourth, no financing for the transaction can be provided by any branch or affiliate of a foreign banking entity that is located in the United States or organized under the laws of the United States or of any state (the "financing prong"). Fifth, the transaction must generally not be conducted with or through any U.S. entity (the "counterparty prong"), unless: (1) no personnel of a U.S. entity that are located in the United States are involved in the arrangement, negotiation, or execution of such transaction; (2) the transaction is with an unaffiliated U.S. market intermediary acting as principal and is promptly cleared and settled through a central counterparty; or (3) the transaction is executed through an unaffiliated U.S. market intermediary acting as agent, conducted anonymously through an exchange or similar trading facility, and is promptly cleared and settled through a central counterparty.[363]

As discussed elsewhere in this Supplementary Information, the Agencies recognize that foreign banking entities seeking to rely on the exemption for trading outside the United States face a complex set of compliance requirements that may result in implementation inefficiencies. In particular, the application of the financing prong may be challenging because of the fungibility of some forms of financing. In addition, the Agencies recognize that satisfying the counterparty prong is burdensome for foreign banking entities and may have led some foreign banking entities to reduce the range of counterparties with which they engage in trading activity.

ii. **Costs and Benefits**

The proposed amendments remove the financing and counterparty prongs.

Under the proposed rule, financing for the transaction relying on the foreign trading exemption can be provided by U.S. branches or affiliates of foreign banking entities, including

[363] *See* 2013 final rule § __.6(e)(3).

SEC-registered dealers. Foreign banking entities may benefit from the proposed amendments and enjoy greater flexibility in financing their transaction activity. However, some of the economic exposure and risks of proprietary trading by foreign banking entities would flow not just to the foreign banking entities, but to U.S.-located entities financing the transactions, e.g., through margin loans. While SEC-registered banking entity dealers financing the transactions of foreign entities are themselves subject to the substantive requirements of the 2013 final rule, SEC-registered dealers that are not banking entities under the BHC Act are not. The proposal retains the requirement that the transactions of a foreign banking entity, including any hedging trades, are not to be accounted for as principal directly or on a consolidated basis by any U.S. branch or affiliate.

In addition, the proposed amendment removes the counterparty prong and its corresponding clearing and anonymous exchange requirements. Currently, a foreign banking entity may transact with or through U.S. counterparties if the trades are conducted anonymously on an exchange (for trades executed by a counterparty acting as an agent) and cleared and settled through a clearing agency or derivatives clearing organization acting as a central counterparty (for trades executed by a counterparty acting as either an agent or principal). As a result, the proposed amendments would make it easier for foreign banking entities to transact with or through U.S. counterparties. To the extent that foreign banking entities are currently passing along compliance burdens to their U.S. counterparties, or are unwilling to intermediate or engage in certain transactions with or through U.S. counterparties, the proposed amendments may reduce transaction costs for U.S. counterparties and may increase the volume of trading activity between U.S. counterparties and foreign banking entities.

We note that, even when a foreign banking entity engages in proprietary trading through a U.S. dealer, the principal risk of the foreign banking entities' position is consolidated to the foreign banking entity. While such trades expose the counterparty to risks related to the transaction, such risks born by U.S. counterparties likely depend on both the identity of the counterparty and the nature of the instrument and terms of trading position. Moreover, concerns about moral hazard and the volume of risk-taking by U.S. banking entities may be less relevant for foreign banking entities. The current requirement that foreign banking entities transact with U.S. counterparties through unaffiliated dealers steers trading business to unaffiliated U.S. dealers but does not necessarily reduce moral hazard in the U.S. financial system.

iii. **Efficiency, Competition, and Capital Formation**

The proposed amendments would likely narrow the scope of transaction activity and banking entities to which the substantive prohibitions of the 2013 final rule apply. As a result, the amendments may reduce the effects on efficiency, competition, and capital formation of the implementing rules currently in place. The proposed amendments reflect consideration of the potentially inefficient restructuring undergone by foreign banking entities after the 2013 final rule came into effect and enhanced access to securities markets by U.S. market participants on the one hand,[364] and, advancing the objectives of the 2013 final rule as discussed above on the other.

Allowing foreign banking entities to be financed by U.S.-dealer affiliates and to transact with U.S. counterparties off exchange and without clearing the trades, may reduce costs of non-

[364] For instance, a commenter has stated that at least seven international banks have terminated or transferred existing transactions with U.S. counterparties in order to comply with the foreign trading exemption and to avoid compliance costs of relying on alternative exemptions or exclusions. *See supra* note 18.

U.S. banking entities' activity in the United States and with U.S. counterparties. These costs may currently represent barriers to entry for foreign banking entities that contemplate engaging in trading and other transaction activity using a U.S. affiliate's financing and trading with U.S. counterparties off exchange. To that extent, the proposed amendments may provide incentives for foreign banking entities that currently receive financing from non-U.S. affiliates to move financing to U.S. dealer affiliates, and incentives for foreign banking entities that currently transact through or with U.S. counterparties via anonymous exchanges and clearing agencies to transact through or with U.S. counterparties outside of anonymous exchanges and clearing. As a result, the number of banking entities engaging in securities trading in U.S. markets may increase, which may enhance the incorporation of new information into prices. However, the amendments may result in a shift in securities trading activity away from U.S. banking entities to foreign banking entities that are not comparably regulated. Thus, the amendments may reduce the benefits and costs of the 2013 final rule discussed in section V.D.1.

The proposed amendments may increase market entry as they will decrease the need for foreign banking entities to rely only on a narrow set of unaffiliated market intermediaries for the purposes of avoiding the compliance costs associated with the 2013 final rule. Additionally, the proposed amendments may increase operational efficiency of trading activity by foreign banking entities in the United States, which may decrease costs to market participants and may increase the level of market participation by U.S-dealer affiliates of foreign banking entities.

The proposed amendments would also affect competition among banking entities. These amendments may introduce competitive disparities between U.S. and foreign banking entities. Under the proposed amendments, foreign banking entities would enjoy a greater degree of flexibility in financing proprietary trading and transacting through or with U.S. counterparties.

At the same time, U.S. banking entities would not be able to engage in proprietary trading and would be subject to the substantive prohibitions of section 13 of the BHC Act. To the extent that banking entities at the holding company level may be able to reorganize and move their business to a foreign jurisdiction, some U.S. banking entity holding companies may exit from the U.S. regulatory regime. However, under sections 4(c)(9) and 4(c)(13) of the Banking Act, domestic entities would have to conduct the majority of their business outside the United States to become eligible for the exemption. In addition, certain changes in control of banks and bank holding companies require supervisory approval. Hence, the feasibility and magnitude of such regulatory arbitrage remain unclear.

To the extent that foreign banking entities currently engage in cleared and anonymous transactions through or with U.S. counterparties because of the existing counterparty prong but would have chosen not to do so otherwise, the proposed approach may reduce the amount of cleared transactions and the trading volume in anonymous markets. This may reduce opportunities for risk-sharing among market participants and increase idiosyncratic counterparty risk born by U.S. and foreign counterparties.

At the same time, the proposed amendments may increase the availability of liquidity and reduce transaction costs for market participants seeking to trade in U.S. securities markets. To the extent that non-U.S. banking entities will face lower costs of transacting with U.S. counterparties, it may become easier for U.S. banking entities or customers to find a transaction counterparty that would be willing to engage in, for instance, hedging transactions. To that extent, U.S. market participants accessing securities markets to hedge financial and commercial risks may increase their hedging activity and assume a more efficient amount of risk. The potential consequences of relocation of non-U.S. banking entity activity to the United States on

liquidity and risk sharing would be most concentrated in those asset classes and market segments where activity is most constrained by current requirements.

f. Metrics Reporting

i. **Regulatory Baseline**

The regulatory baseline against which we are assessing proposed amendments includes requirements for banking entities with consolidated trading assets and liabilities above $10 billion to record and report certain quantitative measurements for each trading desk engaged in covered trading.[365] The metrics-reporting requirements currently in place were intended to facilitate monitoring of patterns in covered trading activities and to identify activities that may warrant further review for compliance with the restrictions on proprietary trading of section 13 of the BHC Act and the implementing rules.

Specifically, the quantitative measurements reported under the baseline were intended to assist banking entities and the SEC in achieving the following: a better understanding of the scope, type, and profile of covered trading activities; identification of covered trading activities that warrant further review or examination by the banking entity to verify compliance with the rule's proprietary trading restrictions; evaluation of whether the covered trading activities of trading desks engaged in permitted activities are consistent with the provisions of the permitted activity exemptions; evaluation of whether the covered trading activities of trading desks that are engaged in permitted trading activities (i.e., underwriting and market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies; identification of the profile of particular covered trading

[365] *See* 2013 final rule § __.20(d) and Appendix A.

activities of the banking entity, and its individual trading desks, to help establish the appropriate frequency and scope of the SEC's examinations of such activity; and the assessment and addressing of the risks associated with the banking entity's covered trading activities.[366]

Under the regulatory baseline, dealers affiliated with banking entities that have less than $10 billion in consolidated trading assets and liabilities are not subject to the 2013 final rule's metrics reporting and recordkeeping requirements. Group A entities (i.e., SEC registrants affiliated with banking entities that have more than $10 billion in consolidated trading assets and liabilities) are required to record and report the following quantitative measurements for each trading day and for each trading desk engaged in covered trading activities: (i) Risk and Position Limits and Usage; (ii) Risk Factor Sensitivities; (iii) Value-at-Risk and Stress Value-at-Risk; (iv) Comprehensive Profit and Loss Attribution; (v) Inventory Turnover; (vi) Inventory Aging; and (vii) Customer-Facing Trade Ratio.

Currently, Group A entities affiliated with banking entities that have less than $50 billion in consolidated trading assets and liabilities are required to report metrics for each quarter within 30 days of the end of that quarter. In contrast, Group A entities affiliated with banking entities with total trading assets and liabilities equal to or above $50 billion are required to report metrics more frequently—each month within 10 days of the end of that month.[367] Table 2 quantifies the number and trading book of SEC-registered broker-dealers affiliated with firms above and below the $10 billion and $50 billion thresholds.

ii. **Costs and Benefits**

[366] *See* 2013 final rule § __.20 and Appendix A.

[367] *See* 2013 final rule § __.20(d)(3).

We understand that the current metrics reporting and recordkeeping requirements may involve large compliance costs. For instance, the average cost of collecting and filing metrics subject to the reporting requirements may be as high as $2 million per year per participant, and market participants may submit an average of over 5 million data points in each filing.[368] One firm reported incurring approximately $3 million in costs associated with the build out of new IT infrastructure and system enhancements, and estimated that this IT infrastructure will require at least $250,000 in maintenance and operating costs year-to-year.[369] In addition, the same firm estimated costs related to compliance consultants assisting with the construction of a 2013 final rule compliance regime at $3 million.[370]

The proposed amendments streamline the metrics reporting and recordkeeping requirements, eliminating or adding particular metrics on the basis of regulatory experience with the data and providing some entities with additional reporting time. Broadly, metrics reporting provides information for regulatory oversight and supervision but presents compliance burdens for registrants. The balance of these effects turns on the value of different metrics in evaluating covered trading activity for compliance with the rule, as well as their usefulness for risk assessment and general supervision. We discuss these effects with respect to each proposed amendment in the sections that follow.

A. Reporting and Recordkeeping Burden for SEC-Regulated Banking Entities

In section V.B, the Agencies estimate that extending the reporting period for banking entities with $50 billion or more in trading assets and liabilities from10 days to 20 days after the

[368] *See supra* note 18.

[369] *Id.*

[370] To the extent that costs related to compliance consulting include both costs of metrics reporting and related systems, as well as costs related to other compliance requirements under the 2013 final rule, we cannot estimate the firm's all-in metrics reporting costs.

end of each calendar month may decrease the initial setup cost by $85,399 and ongoing annual reporting cost by $358,677 for broker-dealers, as well as initial setup cost decrease of up to $100,123 and ongoing reporting costs decrease of up to $420,517 for SBSDs that choose to register with the SEC.[371] In addition, the change to the reporting period for banking entities with $50 billion or more in trading assets and liabilities may result in ongoing annual recordkeeping cost savings of $76,859 for broker-dealers and up to $90,111 for SBSDs.[372] These figures reflect the estimated burden reductions net of any new systems costs imposed by the proposed amendments and discussed in greater detail in the section that follows.

The proposed amendments generate both costs (from new reporting requirements) and savings (from limitations to the scope of certain metrics and reduced analytical burden). To the extent that the costs of compliance with the existing metrics requirements have a significant fixed cost component and may be sunk, the potential cost savings of the proposed amendments may be reduced. The SEC recognizes that while these amendments will reduce the aggregate metrics reporting and recordkeeping burden across all types of banking entities, the allocation of these costs and benefits may differ across banking entity types. For example, one of the proposed amendments replaces the Inventory Turnover and Customer-Facing Trade Ratio

[371] Initial setup cost reduction for broker-dealers: 40 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 29 firms = $85,399. Initial setup cost reduction for entities that may register as SBSDs: 40 hours per firm x 0.18 weight x (Attorney at $409 per hour) x 34 firms= $100,123. Ongoing reporting cost reduction for broker-dealers: 14 hours per response x 12 responses per year x 0.18 weight x (Attorney at $409 per hour) x 29 firms= $358,677. Ongoing reporting cost reduction for SBSDs: 14 hours per response x 12 responses per year x 0.18 weight x (Attorney at $409 per hour) x 34 firms = $420,517. The estimate for SBSDs assumes that all 34 SBSDs have more than $50 billion in trading assets and liabilities.

[372] Ongoing recordkeeping cost reduction for broker-dealers: 3 hours per response x 12 responses per year x 0.18 weight x (Attorney at $409 per hour) x 29 firms = $76,859. Ongoing recordkeeping cost reduction for SBSDs: 3 hours per response x 12 responses per year x 0.18 weight x (Attorney at $409 per hour) x 34 firms = $90,111. The estimate for SBSDs assumes that all 34 have more than $50 billion in trading assets and liabilities.

metrics with Positions and Transaction Volumes metrics, and limits the scope of these metrics to trading desks engaged in market-making and underwriting activities. Because SEC-registered dealers are routinely engaged in market-making and underwriting activities, we preliminarily expect that a greater share of the costs associated with the Positions and Transaction Volumes metrics, such as the costs associated with tagging intra-company and inter-affiliate transactions for purposes of the Transaction Volumes metric, may fall on SEC-regulated entities, while a greater share of the savings, such as the savings associated with the elimination of this reporting requirement for desks engaged solely in risk-mitigating hedging activities, may be allocated to non-SEC-regulated banking entities.

The SEC preliminarily believes reporters will need to modify existing systems to comply with the proposed amendments.[373] On the basis of its experience in similar rulemakings, the SEC believes that the costs necessary to modify existing systems used to comply with the proposed metrics reporting and recordkeeping amendments[374] would depend on the particular structure and activities of each SEC-regulated banking entity's trading desks.[375] In order to

[373] In addition, SEC-regulated banking entities may incur costs associated with reporting metrics in accordance with the XML Schema published on each Agency's website. We discuss these costs below.

[374] We believe that affiliated SEC-regulated banking entities will collaborate with one another to take advantage of efficiencies that may exist and have factored that assumption into our analysis.

[375] This estimate also includes personnel costs associated with preparing the proposed narrative statement. These cost estimates are based, in part, on staff experience, as well as consideration of recent estimates of the one-time and ongoing systems costs associated with other SEC rulemakings. *See, e.g.*, Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 78321 (July 14, 2016), 81 FR 53546, 53629 (Aug. 12, 2016) (estimating the one-time costs for trade execution platforms and registered clearing agencies to develop transaction processing systems and report transaction-level information to swap data repositories); *see also* Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 78011 (June 8, 2016), 81 FR 39807, 39839 (June 17, 2016) (estimating the one-time costs for registered security-based swap dealers and major participants to develop internal order and trade management systems to electronically process transactions and send trade acknowledgments).

allocate the estimated aggregate costs across the various proposed amendments, we make several assumptions about the relative costs of the proposed amendments, as described below. These assumptions are based on the SEC's experience with reporters, as well as the SEC's preliminary belief that the most significant component of the estimated costs will be the initial implementation cost for the new reporting requirements.

The primary systems-related costs of approximately $120,000 to $130,000, estimated at the level of the reporter, will come from: (i) personnel costs associated with preparing the written Narrative Statement for a single reporter that is not already providing this information ($11,000); (ii) costs related to providing data in relation to the Positions and Transaction Volumes metrics that is more granular than is currently required for the Inventory Turnover and Customer Facing Trade Ratio metrics ($8,000); (iii) systems costs related to reporting intra-company and inter-affiliate transactions under the Positions and Transaction Volumes metrics ($7,000); (iv) initial implementation costs for the Quantitative Measurements Identifying Information metric ($26,000); (v) ongoing costs related to the Quantitative Measurements Identifying Information metric ($3,000); (vi) one-time costs of establishing and implementing systems in accordance with the XML Schema ($75,000). As discussed above, we preliminarily believe that the net burden savings estimated in section V.B and monetized in the previous section reflect these new systems costs, as well as gross cost savings from the proposed

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Although the substance and content of systems associated with reporting transaction-level information to swap data repositories and derivatives counterparties would be different from the substance and content of systems associated with reporting quantitative measurements of covered trading activity, the costs associated with the proposed amendments, like the costs associated with the referenced security-based swap rules, would entail gathering and maintaining transaction-level information, and planning, coding, testing, and installing relevant system modifications.

amendments. We discuss these costs, as well as potential benefits of the proposed amendments, in greater detail below.

The SEC further considered how to assess the costs of the proposed rule for SEC-regulated banking entities. The metrics costs are generally estimated at the holding company level for 17 reporters.[376] We then allocate these costs to the affiliated SEC-regulated banking entity.[377] We preliminarily believe that estimating the cost savings of the proposal at the individual registrant level would be inconsistent with our understanding of how these entities are complying with the current metrics reporting requirement. Specifically, we anticipate that SEC-regulated banking entities within the same corporate group will collaborate with one another to comply with the proposed amendments, to take advantage of efficiencies of scale. Further, we note that individual SEC-regulated banking entities may vary in the scope and type of activity they conduct and that not all entities within an organization subject to Appendix A engage in the types of covered trading activity for which metrics must be reported. Thus, to the extent that metrics compliance occurs at the holding company level, estimating costs at the registrant level may overstate the magnitude of the costs and cost savings for SEC-regulated entities from the proposed amendments.

We considered an alternative approach to estimating costs of the proposed metrics amendments—specifically, doing so at the trading desk level. We anticipate that individual trading desks and their personnel may not be directly involved in complying with the full scope

[376] The SEC currently receives metrics from 19 entities, including two reporters that are below $10 billion in trading assets and liabilities, and two reporters that belong to the same holding company. Since voluntary reporters are not constrained by the requirements of the proposed amendment, they are not reflected in our cost estimates. In addition, we believe that the additional systems costs estimated here will be incurred at the holding company level and scope in the trading activity of all SEC-registered banking entity affiliates.

[377] *See supra* note 321.

of the proposed amendments. For example, the Quantitative Measurements Identifying Information and the Narrative Statement must be prepared and reported collectively for all relevant trading desks. We also expect that trading desks within the same holding company could share systems to implement many of the proposed amendments to the quantitative measurements. Thus, a cost estimate at the trading desk level may not be an accurate proxy of the costs of the proposed amendments to SEC-regulated banking entities. Hence, such an analytical approach is likely to overestimate the total cost savings of the proposed amendments to SEC-regulated entities.

B. Elimination, Replacement, and Streamlining of Certain Metrics

The proposed amendments replace the Inventory Aging metric with a Securities Inventory Aging metric and eliminate the Inventory Aging metric for derivatives. In addition, the proposed amendments remove the requirement to establish and report limits on Stressed Value-at-Risk (VaR) at the trading desk level, replace the Customer-Facing Trade Ratio metric with a new Transaction Volumes metric, replace Inventory Turnover with a new Positions metric (reflecting both securities and derivatives positions), streamline valuation of metrics calculations for comparability, limit certain metrics to market-making and underwriting desks, modify instructions for metrics reporting, including with respect to profit and loss attribution, and remove metrics that can be calculated from other reported measurements.

In general, the key economic tradeoff from metrics reporting is between compliance burdens, which may be particularly significant for smaller Group A entities, and the amount and usefulness of information provided for regulatory oversight of the 2013 final rule, as well as for general supervision and oversight. The proposed limitation of certain metrics to market-making and underwriting desks, elimination of the inventory aging metric, and removal of the Stressed

VaR risk limit requirements may reduce burdens related to reporting and recordkeeping for Group A entities. As proprietary trading activity is inherently difficult to distinguish from permitted market making, risk-mitigating hedging, or underwriting activity, certain metrics may provide additional information that is useful for regulatory oversight. However, eliminating inventory turnover and Stressed VaR metrics should not reduce the benefits of metrics reporting, as, these metrics do not enable a clear identification of prohibited proprietary trading or exempt market-making, risk-mitigating hedging, or underwriting activities.

The proposed amendments replace the Inventory Turnover metric with the Positions quantitative measurement and replace the Customer-Facing Trade Ratio metric with the Transaction Volumes quantitative measurement. The Inventory Turnover and Customer-Facing Trade Ratio metrics are ratios that measure the turnover of a trading desk's inventory and compare the transactions involving customers and non-customers of the trading desk, respectively. The proposed Positions and Transaction Volumes metrics would provide information about risk exposure and trading activity at a more granular level. Specifically, the proposed rule requires that banking entities provide the relevant Agency with the underlying data used to calculate the ratios for each trading day, rather than providing more aggregated data over 30-, 60-, and 90-day calculation periods. By providing more granular data, the proposed Positions metric, in conjunction with the proposed Transaction Volumes metric, is expected to provide the SEC with the flexibility to calculate inventory turnover ratios and customer-facing trade ratios over any period of time, including a single trading day, allowing the use of the calculation method we find most effective for monitoring and understanding trading activity.

In addition, the new Positions and Transaction Volumes metrics will distinguish between securities and derivatives positions, unlike the Inventory Turnover and Customer-Facing Trade

Ratio metrics. The proposed Positions and Transaction Volumes metrics would require a banking entity to separately report the value of securities positions and the value of derivatives positions. While the current Inventory Turnover and Customer-Facing Trade Ratio metrics require banking entities to use different methodologies for valuing securities positions and derivatives positions because of differences between these asset classes, these metrics currently require banking entities to aggregate such values for reporting purposes. By combining separate and distinct valuation types (e.g., market value and notional value), the Inventory Turnover and Customer-Facing Trade Ratio metrics are currently providing less meaningful information than was intended. Therefore, requiring banking entities to disaggregate the value of securities positions and the value of derivatives positions for reporting purposes may enhance the usability of this information.

In addition to requiring separate reporting of the value of securities positions and the value of derivatives positions, the proposed rule would also streamline valuation method requirements for different product types. We understand that certain valuation methodologies currently required by the Inventory Turnover and the Customer-Facing Trade Ratio metrics may not be otherwise used by banking entities (e.g., for internal monitoring or external reporting purposes). Furthermore, current requirements result in information being aggregated and furnished to the SEC in non-comparable units. Therefore, the proposed requirement to report notional and market value for all derivatives positions may further enhance the usability of the information provided in the Positions and Transaction Volumes metrics.

Moreover, the valuation methods required under the proposed rule are intended to be more consistent with our understanding of how banking entities value securities and derivatives positions in other contexts, such as internal monitoring or external reporting purposes, which

may allow them to leverage existing systems and reduce ongoing costs relatively to the costs of current reporting requirements. While a banking entity may incur one-time costs in modifying how it values certain positions for purposes of metrics reporting, we do not expect such systems costs to be significant, particularly if the banking entity is able to use the systems it currently has in place for purposes of metrics reporting to value positions consistent with the proposed rule.

Notably, the SEC does not anticipate that requiring banking entities to provide more granular data in the Positions and Transaction Volumes metrics will significantly alter the costs associated with the current Inventory Turnover and Customer-Facing Trade Ratio metrics. The Positions and Transaction Volumes metrics are based on the same underlying data regarding the trading activity of a trading desk as the Inventory Turnover and Customer-Facing Trade Ratio metrics, so we expect that banking entities already keep records of these data and have systems in place that collect these data. However, the SEC anticipates that reporting more granular information in the Positions and Transaction Volumes metrics may result in costs of $24,480.[378]

Similar to the Customer-Facing Trade Ratio, the proposed Transaction Volumes metric would require banking entities to identify the value and the number of transactions a trading desk conducts with customers and non-customers. However, the proposed Transaction Volumes metric would add two additional categories of counterparties to capture the value and number of internal transactions a trading desk conducts. These include transactions booked within the same banking entity (intra-company) and those booked with an affiliated banking entity (inter-affiliate). These additional categories of information should facilitate better classification of internal transactions, which may assist the SEC in evaluating whether the trading desk's

[378] The SEC anticipates that costs associated with the more granular reporting in the Positions and Transaction Volumes metrics will be $8,000 per affiliated group of SEC-regulated banking entities. ($8,000 x 17 reporters x 0.18 SEC-registered banking entity weight) = $24,480.

activities are consistent with the requirements of the exemptions for underwriting or market making-related activity. The SEC estimates that modifying the current requirements of the Customer-Facing Trade Ratio to require SEC-regulated banking entities to further categorize trading desk transactions may impose additional systems costs related to tagging internal transactions and maintaining associated records valued at $21,420.[379]

In addition, we anticipate that the proposed Positions and Transaction Volumes metrics may reduce costs compared to the current reporting requirements by limiting the scope of trading desks that must provide the position- and trade-based data that is currently required by the Inventory Turnover and Customer-Facing Trade Ratio metrics. Under the 2013 final rule, banking entities are required to calculate and report the Inventory Turnover and the Customer-Facing Trade Ratio metrics for all trading desks engaged in covered trading activity. The proposal would limit the scope of trading desks for which a banking entity would be required to calculate and report the Positions and Transaction Volumes metrics to only those trading desks engaged in market making-related activity or underwriting activity. As noted above, we do not expect SEC-regulated banking entities to realize the same amount of cost savings as other banking entities would with respect to this aspect of the proposed rule, since SEC-regulated banking entities are the entities that typically engage in market making-related and underwriting activities.

C. New Qualitative Information: Trading Desk, Narrative Statement, and Descriptive Information

The proposed amendments require banking entities to provide additional information. Specifically, the proposal requires entities to provide: (1) desk level qualitative information

[379] The SEC estimates that the additional costs associated with categorizing transactions under the Transaction Volumes metric will be $7,000 per reporter. ($7,000 x 17 reporters x 0.18 SEC-registered banking entity weight) = $21,420.

about the types of financial instruments the desk uses and covered trading activity the desk conducts, and about the legal entities into which the trading desk books trades; (2) a narrative describing changes in calculation methods, trading desk structure, or trading desk strategies; (3) descriptive information about reported metrics, including information uniquely identifying and describing risk measurements and identifying the relationships of these measurements within a trading desk and across trading desks.

D. Trading Desk Information and Narrative Statement

As recognized in Appendix A of the 2013 final rule, the effectiveness of particular quantitative measurements may differ depending on the profile of a particular trading desk, including the types of instruments traded and trading activities and strategies.[380] Thus, the additional qualitative information the Agencies propose to collect in the Trading Desk Information provision may facilitate SEC review and analysis of covered trading activities and reported metrics. For instance, the proposed trading desk description may help the SEC assess the risks associated with a given activity and establish the appropriate frequency and scope of examination of such activity.

The Agencies are also proposing to require banking entities to provide a Narrative Statement that describes any changes in calculation methods used, a description of and reasons for changes in the trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement must also include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used. If a banking entity does not have any information to report in the Narrative Statement, it must submit an electronic document stating that it does not have any information to

[380] *See* 79 FR at 5798.

report. The Narrative Statement will provide banking entities with an opportunity to describe and explain unusual aspects of the data or modifications that may have occurred since the last submission, which may facilitate better evaluation of the reported data.

The SEC anticipates that the proposed Trading Desk Information and Narrative Statement may enhance the efficiency of data review by regulators. Having access to both quantitative data and qualitative information for trading desks in each submission may allow the SEC to consider the specifics of each trading desk's activities during the reporting period, which may facilitate our ability to monitor patterns in the quantitative measurements.

We note that all the SEC-regulated entities that currently report Appendix A metrics are also currently providing certain elements of the proposed Trading Desk Information to the SEC. Therefore, we preliminarily believe that the costs of gathering the relevant Trading Desk Information as well as the benefits of this requirement may be de minimis.

The costs associated with preparing the Narrative Statement will depend on the extent to which a banking entity modifies its calculation methods, makes changes to a trading desk's structure or trading strategies, or otherwise has additional information that it views as relevant for assessing the information reported. Preparation of a Narrative Statement is expected to be a more manual process involving a written description of pertinent issues. However, all but one SEC reporter already provides a narrative with every submission. Thus, the proposed Narrative Statement requirement is expected to result in ongoing personnel and monitoring costs of only $1,980.[381] Since only one SEC reporter is likely to be affected by this amendment, we believe the benefits of the requirement will be de minimis.

[381] The SEC estimates that costs associated with the proposed Narrative Statement will be $11,000 per affiliated group of SEC-regulated banking entities. ($11,000 x 1 reporter x 0.18 entity) = $1,980.

E. Quantitative Measurements Identifying Information

The Agencies are proposing to require banking entities to report a Risk and Position Limits Information Schedule, a Risk Factor Sensitivities Information Schedule, a Risk Factor Attribution Schedule, a Limit/Sensitivity Cross-Reference Schedule, and a Risk Factor Sensitivity/Attribution Cross-Reference Schedule. This additional information may improve our understanding of how reported limits and risk factors relate to each other for one or more trading desks, both within the same reporting period and across reporting periods. The SEC preliminarily believes that, while these new reporting elements may increase compliance costs for banking entities, the information contained in the reports may allow for more meaningful interpretation of quantitative metrics data.

Banking entities will incur certain initial implementation costs to develop these schedules of information, including costs associated with developing unique identifiers for all limits, risk factor sensitivities, and risk factor or other factor attributions used by the banking entity and brief descriptions of all such limits, sensitivities, and factors. This will include personnel costs to prepare the descriptions and systems costs to collect and maintain the relevant information for each schedule. The SEC estimates initial implementation costs associated with the proposed Quantitative Measurements Identifying Information at $79,560.[382] There will also likely be ongoing maintenance costs associated with updating and storing the information schedules and ongoing monitoring costs to ensure that the information schedules continue to accurately describe the banking entity's reported limits, sensitivities, and factors over time. However, since this information is not expected to change significantly from reporting period to reporting period,

[382] The SEC estimates that the costs associated with the initial implementation of the Quantitative Measurements Identifying Information will be $26,000 per affiliated group of SEC-regulated banking entities. ($26,000 x 17 reporters x 0.18 entity weight) = $79,560.

banking entities should be able to routinize the preparation of these information schedules to minimize or mitigate ongoing costs. We estimate the proposed Quantitative Measurements Identifying Information will result in $9,180 of ongoing costs.[383] To limit burdens associated with reporting the identifying and descriptive information covered by the Quantitative Measurements Identifying Information, the proposed rule requires a banking entity to report this information in the relevant information schedule for the entire banking entity rather than for each trading desk.

F. XML Format

The Agencies are proposing to require banking entities to submit the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement in accordance with the XML Schema specified and published on the relevant Agency's website.[384] The metrics are not currently required to be reported in a structured format, and banking entities are currently reporting quantitative measurement data electronically. On the basis of discussions with metrics reporters, most of these entities indicated a familiarity with XML, and further, several indicated that they use XML internally for other reporting purposes. In addition, we note that banks currently submit quarterly Reports of Condition and Income ("Call Reports") to the Federal Financial Institutions Examination Council ("FFIEC") Central Data Repository in eXtensible Business Reporting Language ("XBRL") format, an XML-based reporting language, so they are generally familiar with the processes and technology for submitting regulatory reports in a structured data format. We

[383] The SEC estimates that the ongoing costs associated with the Quantitative Measurements Identifying Information will be $3,000 per affiliated group of SEC-regulated banking entities per year. ($3,000 x 17 reporters x 0.18 entity weight) = $9,180.

[384] XML is an open standard, meaning that it is a technological standard that is widely available to the public at no cost. XML is also widely used across the industry.

believe that familiarity with these practices at the bank level will facilitate the implementation of these practices for affiliated SEC registrants. Furthermore, FINRA requires its member broker-dealers to file their FOCUS Reports in a structured format through its eFOCUS system.[385] The eFOCUS system permits broker-dealers to import the FOCUS Report data into a filing using an Excel, XML, or text file. Therefore, the SEC preliminarily believes that all SEC-registered dealers covered by the metrics reporting and recordkeeping requirements have experience applying the XML format to their data.

Reporting metrics and other information in XML allows data to be tagged, which in turn identifies the content of the underlying information. The data then becomes instantly machine-readable through the use of standard software. Requiring banking entities to submit the metrics in accordance with the XML Schema would enhance the ability to process and analyze the data. Once the data is in a structured format, it can easily be organized for viewing, manipulation, and analysis through the use of commonly used software tools and applications. Structured data allows users to discern patterns from large quantities of information much more easily than unstructured data. Structured data also facilitates users' abilities to dynamically search, aggregate, and compare information across submissions, whether within a banking entity, across multiple banking entities, or across multiple date ranges. The data supplied in a structured format could help the SEC identify outliers or trends that could warrant further investigation.

The XML Schema would also incorporate certain validations to help ensure consistent formatting among all reports—in other words, it would help ensure data quality. The validations

[385] For example, FINRA members commonly use FINRA's Web EFT system, which requires that all data be submitted in XML. *See* Web EFT Schema Documentation and Schema Files, FINRA, http://www.finra.org/industry/web-crd/web-eft-schema-documentation-and-schema-files; *see also* Disclosure of Order Handling Information, Exchange Act Release No. 78309 (July 13, 2016), 81 FR 49431, 49499 (July 27, 2016). Information about FINRA's eFOCUS system is available at http://www.finra.org/industry/focus.

are restrictions placed on the formatting for each data element so that data is presented comparably. Requiring banking entities to report using the XML Schema may help ensure timely access to the data in a format that is already consistent and comparable for automated machine-processing and analysis. However, these validations are not designed to ensure the underlying accuracy of the data. Any reports provided by banking entities under the proposed requirement would have to comply with these validations that are incorporated within the XML Schema; otherwise the reports would not be considered to have been provided using the XML Schema specified and published on the SEC's website.

Specifying the format in which banking entities must report information may help the Agencies ensure that we receive consistently comparable information in an efficient manner across banking entities. The costs associated with providing XML data lie in the specialized software or services required to make the submission and the time required to map the required data elements to the requisite taxonomy. In addition to enhanced viewing, manipulation, and analysis, the benefits associated with providing XML data lie in the enhanced validation tools that minimize the likelihood that data are reported with errors. Therefore, subsequent reporting periods may require fewer resources, relative to both initial reporting periods and the current reporting process.

We expect that the requirement to submit the Narrative Statement electronically will result in minimal information systems costs, as banking entities already have systems in place to submit information to the SEC electronically. However, the SEC recognizes that, as a result of the proposed amendments, banking entities will be required to establish and implement systems

in accordance with the XML Schema that will result in one-time costs[386] of approximately $75,000 per holding company banking entity, on average, for an expected aggregate one-time cost of approximately $229,500.[387] Because we expect that XML reporting will result in a more efficient submission process, including validation of submissions, we anticipate that some of the implementation costs may be partially offset, over time, by these greater efficiencies.

G. Extended Time to Report

The proposed changes also extend the time to report metrics for different groups of filers. Because processes enabling reporting under tight deadlines may generally be costlier, we anticipate that the amended reporting requirements may marginally reduce compliance costs, particularly for filers with less sophisticated data and trading infrastructure. In addition, the

[386] These cost estimates are based in part on the SEC's recent estimates of the one-time systems costs associated with the proposed requirement that security-based swap data repositories ("SDRs") make transaction-level security-based swap data available to the SEC in Financial products Markup Language ("FpML") and Financial Information eXchange Markup Language ("FIXML"). *See* Establishing the Form and Manner with which Security-Based Swap Data Repositories Must Make Security-Based Swap Data Available to the Commission, Exchange Act Release No. 76624 (Dec. 11, 2015), 80 FR 79757 (Dec. 23, 2015) ("SBS Taxonomy rule proposing release"). The SBS Taxonomy rule proposing release estimates a one-time cost per SDR of $127,000. Although the substance of reporting associated with the metrics is different from the information collected and made available by SDRs, the SEC expects similar costs to apply to the implementation of XML for the reporting metrics. In particular, on the basis of its experience with similar structured data reporting requirements in other contexts (e.g., the SBS Taxonomy rule), the SEC expects that systems engineering fixed costs will represent the bulk of the costs related to the XML requirement. Among other things, the proposed SBS Taxonomy rule would require SDRs to make available to the SEC in a specific format (in this case, FpML or FIXML) transaction-level data that they are already required to provide. Similarly, the proposed metrics amendments would require banking entities to produce in XML metrics reports that they are already required (or will be required) to provide. However, our estimate is reduced to account for the fact that registered broker-dealers already provide eFOCUS reports to FINRA in XML and, therefore, must have the requisite systems in place. Our cost estimates include responsibilities for modifications of information technology systems to an attorney, a compliance Manager, a programmer analyst, and a senior business analyst and responsibilities for policies and procedures to an attorney, a compliance Manager, a senior systems analyst, and an operations specialist.

[387] The SEC computes total costs as follows: $75,000 x 17 reporters x 0.18 entity weight = $229,500.

amendments may result in fewer resubmissions by filers. To a limited extent, the proposed amendment may reduce the timeliness of data received from dealers, making supervision less agile. However, the SEC will continue to have access to quantitative metrics and related information through the standard examination and review process and existing recordkeeping requirements.

iii. **Competition, Efficiency, and Capital Formation**

Under the proposed amendments, Group A entities would incur lower costs of compliance with metrics-reporting requirements. To the extent that these compliance burdens may be significant for some Group A entities, and since Group B entities are not subject to any metrics requirements, smaller Group A entities around the threshold may become more competitive with Group B entities. Since metrics are reported only to the Agencies and are not publicly disseminated, this amendment does not change the scope of information available to investors. As such, we do not anticipate effects on informational efficiency to be significant. To the extent that some Group A entities are currently experiencing significant metrics-reporting costs and partially or fully passing them along to customers in the form of reduced access to capital or higher cost of capital, the proposed amendments may reduce costs of and increase access to capital. However, as estimated cost savings from the proposed amendments are small, we do not anticipate a substantial increase in access to capital as a result of the proposed amendments to metrics reporting requirements.

iv. **Alternatives**

The Agencies could have taken alternative approaches. First, the Agencies could keep the metrics being reported unchanged but increase or decrease the trading activity thresholds used to determine metrics recordkeeping and reporting by filers and the frequency of such

reporting. For instance, the $10 billion trading activity threshold for quarterly reporting could be replaced by the $25 billion threshold. As shown in Table 2, we estimate that this alternative would affect 12 bank-affiliated SEC-registered broker-dealers. Under the alternative, these dealers would no longer be required to keep or report metrics, enjoying lower compliance burdens. However, the alternative reduces the amount and frequency of quantitative data available for regulatory oversight of banking entities. Similarly, lowering the recordkeeping and reporting thresholds would increase the scope of application of the metrics reporting requirement, increasing accompanying recordkeeping and reporting obligations as well as potential oversight and supervision benefits. However, we continue to recognize that while metrics being reported under the 2013 final rule do not allow a clear delineation of proprietary trading and market-making or hedging activities, they may be used to flag risks and enhance general supervision, as well as demonstrate prudent risk management.

In addition, the Agencies could have proposed eliminating the VaR requirement. Both VaR and Stressed VaR are based on firm-wide activity, and VaR limits may not be routinely used by banking entities to manage and control risk-taking activities at the desk level. The alternative would remove from Appendix A the requirement for VaR limits because such limits may not be meaningful at the trading desk level. This alternative may reduce the burden of reporting and compliance costs without necessarily reducing the effectiveness of regulatory oversight by the SEC.

The Agencies have also considered eliminating all quantitative metrics recordkeeping and reporting requirements under Appendix A of the 2013 final rule. This alternative would reduce the amount of data produced and transmitted to the Agencies. Appendix A metrics enable regulators to have a more complete picture of risk-taking and profit and loss attribution for

supervised entities. However, the metric reporting regime is costly, and banking entities currently subject to the 2013 final rule and SEC oversight are also subject to other compliance and reporting requirements unrelated to the 2013 final rule, as well as the standard examination and review process. It is not clear that the Appendix A metrics are superior to internal quantitative risk measurements or other data (such as metrics in the FOCUS reports) reported by SEC registered broker-dealers in describing risk exposures and profitability of various activities by SEC registrants. Crucially, Appendix A metrics, such as VaR, dealer inventory, transaction volume, and profit and loss attribution, do not delineate a prohibited proprietary trade and a permitted market making, underwriting or hedging trade, particularly when executed in highly illiquid products and times of stress. Moreover, reporters' flexibility in defining the metrics may reduce their comparability. We recognize that while Appendix A metrics do not allow a clear identification of proprietary trading by SEC registrants, they may be used to flag risks and enhance general supervision, as well as demonstrate prudent risk management.

g. Covered Funds

Section 13 of the BHC Act generally prohibits banking entities from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with covered funds, subject to certain exemptions.[388] The SEC's economic analysis concerns the potential costs, benefits, and effects on efficiency, competition, and capital formation of the proposed covered fund amendments for four groups of market participants. First, the proposed amendments may impact SEC-registered investment advisers that are banking entities, including those that sponsor or advise covered funds and those that do not, as well as SEC-registered investment advisers that are not banking entities that sponsor or advise covered funds and

[388] *See* 12 U.S.C. 1851.

compete with banking entity RIAs. Second, the proposed amendments affect the ability of bank-affiliated dealers to underwrite, make markets, or engage in risk-mitigating hedging transactions involving covered funds. Third, the proposed amendments impact private funds, including those funds scoped in or out of the covered fund provisions of the 2013 final rule, as well as private funds competing with such funds. Fourth, to the extent that the proposed amendments impact efficiency, competition, and capital formation in covered funds or underlying securities, investors in and sponsors of covered funds and underlying securities may be affected as well.

As discussed in greater detail below, the primary economic tradeoff posed by the proposed amendments to the covered fund provisions and other potential changes to these provisions on which the Agencies seek comment is the tradeoff between enhanced competition and capital formation in covered funds and the potential moral hazard and related financial risks posed by fund investments. To the extent that the current covered fund provisions limit fund formation, the proposed amendments and other amendments on which the Agencies seek comment could reduce long-term compliance costs and increase revenues for banking entities, and, as a result, increase capital formation. We are currently not aware of any information or data about the extent to which the covered fund provisions of the 2013 final rule are inhibiting capital formation in funds. Therefore, the bulk of the analysis below is necessarily qualitative.

i. **Definition of "Covered Fund"**

Regulatory Baseline

The definition of "covered fund" impacts the scope of the substantive prohibitions on banking entities' acquiring or retaining an ownership interest in, sponsoring, and having certain relationships with covered funds. The covered fund provisions of the 2013 final rule may reduce the ability and incentives of banking entities to bail out affiliated funds to mitigate reputational

risk; limit conflicts of interest with clients, customers, and counterparties; and reduce the ability of banking entities to engage in proprietary trading indirectly through funds. The 2013 final rule defines covered funds as issuers that would be investment companies but for section 3(c)(1) or 3(c)(7) of the Investment Company Act and then excludes specific types of entities from the definition. The definition also includes certain commodity pools as well as certain foreign funds, but only with respect to a U.S. banking entity that sponsors or invests in the foreign fund. Funds that rely on the exclusions in sections 3(c)(1) or 3(c)(7) of the Investment Company Act are covered funds unless an exemption from the covered fund definition is available; generally, funds that rely on other exclusions in the Investment Company Act, such as real estate and mortgage funds that rely on the exclusion in section 3(c)(5)(C), are not covered funds under the 2013 final rule.

The broad definition of covered funds above encompasses many different types of vehicles, and the 2013 final rule excludes some of them from the definition of a covered fund.[389] The excluded fund types relevant to the baseline are funds regulated under the Investment Company Act, that is, RICs and BDCs. Seeding vehicles for these funds are also excluded from the covered fund definition during their seeding period.[390]

Scope of the Covered Fund Definition: Costs and Benefits

The Agencies are requesting comment on potential modifications to the covered fund definition. For instance, with respect to the foreign public funds exclusion, the Agencies are requesting comment as to whether to remove the condition that, for a foreign public fund

[389] The exclusions from the covered fund definition are set forth in § __.10(c) of the 2013 final rule.

[390] *See* 2013 final rule § __.10(c)(12).

sponsored by a U.S. banking entity, the fund's ownership interests are sold predominantly to persons other than the sponsoring banking entity, affiliates of the issuer and the sponsoring banking entity, and employees and directors of such entities. As another example, the Agencies are requesting comment as to whether to revise the exclusion to focus on the qualification of the fund in foreign jurisdictions and markets as eligible for retail sales, without including requirements related to the manner in which the fund's interests are sold, or to tailor the exclusion's use of the defined term "distribution" to address instances in which a fund's ownership interests generally are sold to retail investors in secondary market transactions, as with foreign exchange-traded funds. The Agencies are also requesting comment on excluding other funds, such as family wealth vehicles, from the scope of the covered fund definition. The Agencies are requesting comment on modifying the loan securitization exclusion to permit limited holdings of debt securities and synthetic instruments in addition to loans. As a final example, the Agencies are requesting comment on revising the covered fund definition to provide an exclusion focused on the characteristics of an entity rather than only whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act or would otherwise come within the covered fund base definition.

Broadly, such modifications to the existing covered fund definition and additional exclusions would reduce the number and types of funds that are impacted by the 2013 final rule. Hence, these alternatives may decrease both the economic benefits and the economic costs of the 2013 final rule's covered fund provisions, as discussed further below.

Form ADV data is not always sufficiently granular to allow us to estimate the number of funds and fund advisers affected by the different modifications to the covered fund definition on which the Agencies are seeking comment. However, Table 3 and Table 4 in the economic

baseline quantify the number and asset size of private funds advised by banking entity RIAs by the type of private fund they advise, as those fund types are defined in Form ADV. These fund types include hedge funds, private equity funds, real estate funds, securitized asset funds, venture capital funds, liquidity, and other private funds.

The Agencies are requesting comment on whether to tailor the covered funds definition by using a characteristics-based exclusion. For instance, the Agencies are requesting comment on whether the covered fund definition should exclude funds that are not hedge funds or private equity funds, as defined in Form PF. This would exclude other types of funds from the covered fund definition (such as venture capital, real estate, securitized asset, liquidity, and all other private funds, as those terms are defined in Form PF).

Using Form ADV data, we preliminarily estimate that approximately 173 banking entity RIAs advise hedge funds and 90 banking entity RIAs advise private equity funds.[391] As can be seen from Table 3 in the economic baseline, 43 banking entity RIAs advise securitized asset funds. Table 4 shows that banking entity RIAs advise 360 securitized asset funds with $120 billion in gross assets. Another 56 banking entity RIAs advise real estate funds, and banking entity RIAs advise 323 real estate funds with $84 billion in gross assets. Venture capital funds are advised by only 16 banking entity RIAs, and all 42 venture capital funds advised by RIAs have on aggregate approximately $2 billion in gross assets.

As noted elsewhere in this Supplementary Information, the covered fund provisions of the 2013 final rule may limit the ability of banking entities to engage in trading through covered funds in circumvention of the proprietary trading prohibition, reduce bank incentives to bailout

[391] As noted in the economic baseline, a single RIA may advise multiple types of funds.

their covered funds, and mitigate conflicts of interest between banking entities and its clients, customers, or counterparties. However, the covered fund definition in the implementing rules is broad, and some have argued that the rules currently in place may limit the ability of banking entities to conduct traditional asset management activities and to promote capital formation. The Agencies recognize that the covered fund provisions of the implementing rules, as currently in effect, may impose significant costs on some entities. The Agencies also understand that the breadth of the covered fund definition requires market participants to review hundreds of thousands of issuers, and potentially more, to determine if the issuers are covered funds as defined in the 2013 final rule. We understand that this has included a review of hundreds of thousands of CUSIPs issued by common types of securitizations for covered fund status.[392] The need to perform an in-depth analysis and make covered funds determinations across such a large scope of entities involves costs and may adversely affect the willingness of banking entities to own, sponsor, and have relationships with covered funds and financial instruments that may be covered funds. Moreover, the 2013 final rule's limitations on banking entities' investment in covered funds may be more significant for covered funds that are typically small in size, with potentially more negative spillover effects on capital formation in underlying securities.[393]

The potential modifications to the covered fund definition on which the Agencies are seeking comment would reduce further the scope of funds that need to be analyzed for covered fund status or would simplify this analysis and would enable banking entities to own, sponsor, and have relationships with certain groups of funds that are currently defined as a covered fund.

[392] *See supra* note 18.

[393] We understand that, for instance, the median venture capital fund size in some locations is approximately $15 million. One fund may have lost as much as $50 million dollars in investment because of the prohibitions of section 13 of the BHC Act and implementing regulations. *See supra* note 18.

Accordingly, these potential modifications may reduce costs of banking entity ownership, sponsorship, and transactions with certain private funds, may promote greater capital formation in, and competition among such funds, and may improve access to capital for issuers of underlying debt or equity. They may also benefit banking entity dealers through higher profits or more underwriting business. Reducing the covered fund restrictions by further tailoring the covered fund definition may encourage more launches of funds that are excluded from the definition, increasing capital formation and, possibly, competition in those types of funds. If competition increases the quality of funds available to investors or reduces the fees they are charged, investors in funds may benefit.

We do not observe the amount of capital formation in different types of covered funds or underlying equity and debt securities that does not occur because of the 2013 final rule. Because of the prolonged and overlapping implementation timeline of various post-crisis reforms and because market participants restructured their trading and covered funds activities in anticipation of the implementing rules being effective, we cannot measure the counterfactual levels of capital formation and liquidity that would have been observed after the financial crisis, absent the covered fund provisions currently in place. Similarly, we cannot establish whether competition in covered funds is adversely affected by the covered fund definition currently in effect. We solicit any information, particularly quantitative data, that would allow us to estimate the magnitudes of the potential costs and benefits of the covered fund provisions on banking entity-affiliated broker-dealers and investment advisers advising the different types of funds discussed above and any effects on efficiency, competition, and capital formation in different types of funds and their underlying securities.

ii. **Covered Funds: Underwriting, Market Making, and Risk-Mitigating Hedging**

Regulatory Baseline

Under the baseline, as described above, the 2013 final rule provides for market-making and hedging exemptions to the prohibition on proprietary trading. However, the 2013 final rule places tighter restrictions on the amount of underwriting, market making, and hedging a banking entity can engage in when those transactions involve covered funds. For underwriting and market-making transactions in covered funds, if the banking entity sponsors or advises a covered fund, or acts in any of the other capacities specified in § __.11(c)(2) of the 2013 final rule, then any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making-related activities for that particular covered fund must be included in the per-fund and aggregate covered fund investment limits in § __.12 of the 2013 final rule and subject to the capital deduction provided in § __.12(d) of the 2013 final rule.[394] Additionally, a banking entity's aggregate investment in all covered funds is limited to 3 percent of a banking entity's tier 1 capital, and all banking entities must include ownership interests acquired or retained in connection with underwriting and market making-related activities for purposes of this calculation.[395] Moreover, hedging transactions in a covered fund are only permitted if the transaction mitigates risks associated with the compensation of a banking entity employee or an affiliate that provides advisory or other services to the covered fund.[396]

Costs and Benefits

The increased requirements imposed on SEC-registered dealers' transactions in covered funds relative to other securities mean that a dealer may not be able to make markets in a covered

[394] *See* 2013 final rule § __.12(a)(2)(ii); *see also* § __.11(c)(2).

[395] 2013 final rule § __.12(a)(2)(iii); *see also* § __.11(c)(3).

[396] 2013 final rule § __.13(a).

fund or may be limited in its ability to do so, even if the dealer may be able to make markets in the underlying securities owned by the covered fund or securities that are otherwise similar to the covered fund. The Agencies' proposed changes would provide banking entities greater flexibility in underwriting and market making in covered fund interests. Specifically, as discussed elsewhere in this Supplementary Information, for a covered fund that the banking entity does not organize or offer pursuant to § __.11(a) or (b) of the 2013 final rule, the proposal would remove the requirement that the banking entity include, for purposes of the aggregate fund limits and capital deduction, the value of any ownership interests of the covered fund acquired or retained in connection with underwriting or market making-related activities. Under the proposed amendments, these limits, as well as the per fund limit, would only apply to a covered fund that the banking entity organizes or offers and in which the banking entity retains an ownership interest pursuant to § __.11(a) or (b) of the 2013 final rule.

The proposed amendment aligns the requirements for underwriting and market making with respect to ownership interests in covered funds that the banking entity does not organize or offer, with requirements for engaging in these activities with respect to other financial instruments. We understand that the 2013 final rule's restrictions on underwriting and making-related activities involving covered funds impose costs on banking entities and may constrain their underwriting and market making in covered funds. Under the proposed amendments, banking entities would be able to engage in potentially profitable market making and underwriting in covered funds they do not organize or offer without the per-fund and aggregate limits and capital deductions. SEC-registered banking entities are expected to benefit from this amendment to the extent they profit from underwriting and market-making activities in such covered funds. In addition, these benefits may, at least partially, flow through to funds and fund

investors. Specifically, banking entities may become more willing and able to underwrite and make markets in covered funds, and provide investors with more readily available economic exposure to the returns and risks of certain covered funds.

We recognize that ownership interests in covered funds expose owners to the risks related to covered funds. It is possible that covered fund ownership interests acquired or retained by a banking entity acting as an underwriter or engaged in market making-related activities may lead to losses for banking entities. However, we recognize that the risks of market making or underwriting of covered funds are substantively similar to the risks of market making or underwriting of otherwise comparable securities. Therefore, the same general tradeoffs discussed in section V.D.3.c of this Supplementary Information between potential benefits for capital formation and liquidity and potential costs related to moral hazard and market fragility apply to banking entities' underwriting and market-making activities involving covered funds and other types of securities.

Banking entities are also currently unable to retain ownership interests in covered funds as part of routine risk-mitigating hedging. These restrictions may currently be limiting banking entities' ability to hedge the risks of fund-linked derivatives through shares of covered funds referenced by fund-linked products. The Agencies recognized that, as a result of this approach, banking entities may no longer be able to participate in offering certain customer facilitating products relating to covered funds. The Agencies recognized that increased use of ownership interests in covered funds could result in exposure to greater risk.[397] Moreover, banking entities' transactions in fund-linked products that reference covered funds with customers can expose a banking entity to risk in cases where a customer fails to perform, transforming the banking

[397] 79 FR at 5737.

entity's covered fund hedge of the customer trade into an unhedged, and potentially illiquid, position in the covered fund (unless and until the banking entity takes action to hedge this exposure and bears the corresponding costs).

The proposal expands the scope of permissible risk-mitigating hedging with covered funds. Specifically, under the proposal, in addition to being able to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedge with respect to certain compensation agreements as permitted under the 2013 final rule, the banking entity would also be able to acquire or retain an ownership interest in a covered fund when acting as an intermediary on behalf of a non-banking entity customer to facilitate exposure by the customer to the profits and losses of the covered fund.

The proposal is likely to benefit banking entities and their customers, as well as advisers of covered funds. The proposed amendments increase the ability of banking entities to facilitate customer-facing transactions while hedging their own risk exposure. As a result, this amendment may increase banking entity intermediation and provide customers with easier access to the risks and returns of covered funds. To the degree that banking entities' investments in covered funds to hedge customer-facing transactions may facilitate their engagement in customer-facing trades, customers of banking entities may benefit from greater availability of financial instruments providing exposure to covered funds and related intermediation. Access to covered funds may be particularly valuable when private capital plays an increasingly important role in U.S. capital markets and firm financing.

We also recognize that the proposed amendments may increase risks to banking entities. For instance, when a banking entity enters into a transaction with a customer that provides

exposure to the profits and losses of a covered fund to a customer, even when such exposure is hedged, the banking entity may suffer losses if a customer fails to perform and fund investments are illiquid and decline in value. However, such counterparty default risk is present in any principal transaction in illiquid financial instruments, including when facilitating customer trades in the securities in which covered funds invest, as well as in market-making and underwriting activities. We note that, under the proposal, risk-mitigating hedging transactions involving covered funds would be conducted consistent with the requirements of the 2013 final rule, as modified by the proposal, including the requirements with respect to risk-mitigating hedging transactions. For example, such exposures would be subject to required risk limits and policies and procedures and would have to be appropriately monitored and risk managed. Therefore, it is not clear that hedging or customer facilitation in covered funds would pose a greater risk to banking entities than hedging or customer facilitation in similar securities that is permissible under the 2013 final rule.

Alternatives

An alternative would be to provide greater flexibility for underwriting, market making, and risk-mitigating hedging transactions involving covered fund interests. Specifically, the Agencies could consider eliminating the per-fund limit, aggregate fund limit, and capital deduction for a banking entity acting as an underwriter or engaged in market making-related activities with respect to a covered fund that the banking entity organizes and offers. The Agencies also could have proposed amending the 2013 final rule to provide that, in addition to the proposed amendment, banking entities should be permitted to acquire or retain ownership interests in covered funds as risk-mitigating hedging transactions where the acquisition or retention meets the requirements of § __.5 of the 2013 final rule, as modified by the proposal. If

the Agencies made all of these changes, this would provide dealers the same level of flexibility in underwriting, making markets in, or hedging with, covered funds as applied to these activities with respect to all other types of financial instruments, including the underlying financial instruments owned by the same covered funds.

Compliance with current rules for covered funds imposes costs on banking entities. To the extent that, under the baseline, such costs prevent dealer subsidiaries of banking entities from making markets in or underwriting certain financial instruments, the alternative would enable them to engage in potentially profitable market making in, underwriting, and hedging with, covered funds. Banking entity dealers could benefit from this alternative, to the extent they profit from underwriting and market-making activities in covered funds and to the extent that investing in covered funds to hedge a banking entity's exposure in transactions such as total return swaps reduce their risk profile.

The benefits of this alternative may also flow through to funds, investors, and customers. Under the alternative, banking entities would enjoy greater flexibility in transacting in covered funds with customers and in hedging banking entities' exposure with covered funds. As a result, banking entities may become more willing and able to underwrite and market products linked to covered funds and to provide customers with an economic interest in the profits and losses of covered funds. This may increase investor access to the returns and risks of private funds, which may be particularly valuable when issuers are increasingly relying on private capital and delaying public offerings. Finally, the increased ability of banking entities to transact in covered funds under the alternative may increase market quality for covered funds that are traded.

We continue to recognize that transactions in covered funds—including transactions with customers, and holdings of ownership interests in covered funds related to underwriting, market

making, or hedging activities—necessarily involve the risk of losses. However, the risks of market making, underwriting, or hedging by banking entities of financial instruments underlying the covered fund, or financial instruments or securities that are otherwise similar to covered funds, are substantively similar. Therefore, the same tradeoffs discussed in section V.D.3.c in this Supplementary Information between potential benefits to capital formation and liquidity and potential costs related to moral hazard and market fragility apply to both banking entity interests from underwriting and market making in financial instruments and underwriting and market making in covered funds. It is not clear that the existence of a legal and management structure of a covered fund per se changes the economic risk exposure of banking entities, and, thus, the capital formation and other tradeoffs discussed above. We note that the alternative would simply involve a consistent treatment of financial instruments and funds as it pertains to underwriting, market making, and hedging activities. However, as discussed above in section V.D.1of this Supplementary Information, some of the effects of the 2013 final rule's provisions are difficult to evaluate outside of economic downturns, and we are unable to measure the amount of capital formation or liquidity in covered funds or underlying products that does not occur because of the existing treatment of underwriting, market making, and hedging using covered funds.

iii. **Restrictions on Relationships between Banking Entities and Covered Funds Regulatory Baseline**

Under the baseline, banking entities are limited in the types of transactions they are able to engage in with covered funds with which they have certain relationships. Banking entities that serve in certain capacities with respect to a covered fund, such as the fund's investment manager, adviser, or sponsor, are prohibited from engaging in a "covered transaction," as defined in

section 23A of the FR Act, with the covered fund.[398] This prohibits transactions such as loans, guarantees, securities lending, and derivatives transactions that cause the banking entity to have credit exposure to the affiliate. However, the 2013 final rule exempts from the prohibition any prime brokerage transaction with a covered fund in which a covered fund managed, sponsored, or advised by a banking entity has taken an ownership interest (a "second-tier fund"). Therefore, banking entities with a relationship to a covered fund can engage in prime brokerage transactions (that are covered transactions) only with second-tier funds and not with all covered funds.[399]

Costs and Benefits

The Agencies request comments on whether the Agencies should amend § __.14 of the 2013 final rule to incorporate the exemptions under section 23A of the FR Act and the Board's Regulation W, such as intraday extensions of credit that facilitate settlement.[400] As a result of the restrictions on covered transactions in the 2013 final rule, some banking entities may be outsourcing the provision of routine services to sponsored funds, such as custody and clearing services, to outside providers. We recognize that outsourcing such activities may adversely affect customer relationships, increase costs, and decrease operational efficiency for banking entities and covered funds. The changes on which the Agencies seek comment would provide banking entities greater flexibility to provide these and other services directly to covered funds. If being able to provide custody, clearing, and other services to sponsored funds reduces the

[398] *See* 2013 final rule § __.14(a).

[399] *See* 2013 final rule § __.14(c).

[400] The Agencies also are requesting comment as to whether the definition of "prime brokerage transaction" under the proposal is appropriate and, if not, what definition would be appropriate and which transactions should be included in the definition. The costs, benefits, and other implications of expansions to the definition of "prime brokerage transaction" would generally be similar to those associated with the potential changes to § __.14 discussed in this section, except that they likely would be less significant because the statute permits prime brokerage transactions only with second-tier funds and does not extend to covered funds more generally.

costs of these services, fund advisers and, indirectly, fund investors, may benefit from incorporating the exemptions. We note that most direct benefits are likely to accrue to banking entity advisers to covered funds that are currently relying on third-party service providers as a result of the requirements of the 2013 final rule.

These changes would increase banking entities' ability to engage in custody, clearing, and other transactions with their covered funds and benefit banking entities that are currently unable to engage in otherwise profitable or efficient activities with covered funds they own or advise. Moreover, this could enhance operational efficiency and reduce costs incurred by covered funds, which are currently unable to rely on their affiliated banking entity for custody, clearing, and other transactions. Conversely, to the extent that this approach increases transactions between a banking entity and related covered funds, banking entities could incur any risks associated with these transactions, recognizing that the transactions would be subject to the limitations in section 23A of the FR Act and the Board's Regulation W, as well as § __.14(b) of the 2013 final rule and other applicable laws.

iv. **Covered Fund Activities and Investments Outside of the United States**

Regulatory Baseline

Under the 2013 final rule, foreign banking entities can acquire or retain an ownership interest in, or act as sponsor to, a covered fund, so long as those activities and investments occur solely outside the United States, no ownership interest in such fund is offered for sale or sold to a resident of the United States (the "marketing restriction"), and certain other conditions are met. An activity or investment occurs solely outside of the United States if (1) the banking entity is not itself, and is not controlled directly or indirectly by, a banking entity that is located in the United States or established under the laws of the United States or of any state; (2) the banking

entity (and relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under the laws of the United States or of any state; (3) the investment or sponsorship, including any risk-mitigating hedging transaction related to an ownership interest, is not accounted for as principal by any U.S. branch or affiliate; and (4) no financing is provided, directly or indirectly, by any U.S. branch or affiliate. In addition, the staffs of the Agencies issued FAQs concerning the requirement that no ownership interest in such fund is offered for sale or sold to a resident of the United States.

Costs and Benefits

The proposed amendments remove the financing prong of the foreign funds exemption and codify the FAQs regarding marketing of foreign funds to U.S. residents.[401] Thus, under the proposed amendments, foreign banking entities would be able to acquire or retain ownership interests in and sponsor covered funds with financing provided directly or indirectly by U.S. branches and affiliates, including SEC-registered dealers. The costs, benefits, and effects on efficiency, competition, and capital formation of this amendment generally parallel those of the removal of the financing prong with respect to trading activity outside the United States in section V.D.3.e of this Supplementary Information.

Foreign banking entities may benefit from the proposed amendments and enjoy greater flexibility in financing their covered fund activity. Allowing foreign banking entities to obtain financing of covered fund transactions from U.S.-dealer affiliates may reduce costs of foreign banking entity activity in covered funds. The amendment may decrease the need for foreign

[401] We understand that market participants have adjusted their activity in reliance on the FAQs regarding the marketing restriction. Hence, we preliminarily believe that the economic effects of the proposed amendment to reflect the position expressed in the staffs' FAQs are likely to be de minimis and we focus this discussion on the proposed removal of the financing prong.

banking entities to rely on foreign dealer affiliates solely for the purposes of avoiding the compliance costs and prohibitions of the 2013 final rule. This may increase operational efficiency of covered fund activity by foreign banking entities. To the extent that costs of compliance with the foreign fund exemption may currently represent barriers to entry for foreign banking entities' covered fund activities, the proposed amendment may increase foreign banking entities' sponsorship and financing of covered funds.

The economic exposure and risks of foreign banking entities' covered funds activities may be incurred not just by the foreign banking entities, but by U.S. entities financing the covered fund ownership interests, e.g., through margin loans covering particular transactions. However, the proposal retains the requirement that the investment or sponsorship, including any related hedging, is not accounted for as principal by any U.S. branch or affiliate. We continue to note that moral hazard risks and concerns about the volume of U.S. banking entity risk-taking are less relevant when the covered fund activity is conducted by, and the risk consolidates to, foreign banking entities.

Competitive effects of this amendment may differ from the proposed amendment regarding trading activity outside of the United States. Under the proposed amendment to the foreign fund exemption, foreign banking entities will enjoy a greater degree of flexibility and potentially lower costs of financing covered fund transactions outside of the United States. Because the 2013 final rule's exemption for covered funds activities solely outside of the United States is available only to foreign banking entities, the proposed amendments may reduce costs for some foreign banking entities but need not affect the competitive standing of U.S. banking entities relative to foreign banking entities with respect to covered funds activities in the United States.

h. Definition of Banking Entity

As discussed elsewhere in this Supplementary Information, staffs of the Agencies have responded to questions raised regarding the potential treatment of RICs as banking entities as a result of a sponsor's seed investment, as well as issues related to FPFs and foreign excluded funds. The Agencies are continuing to consider the issues raised by the interaction between the 2013 final rule's definitions of the terms "banking entity" and "covered fund," including the issues addressed by the Agencies' staffs and the Federal banking agencies discussed above. Accordingly, the Agencies have made clear that nothing in the proposal would modify the application of the staffs' FAQs discussed above, and the Agencies will not treat RICs or FPFs that meet the conditions included in the applicable staff FAQs as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs. In addition, to accommodate the pendency of the proposal, for an additional period of one year until July 21, 2019, the Agencies will not treat qualifying foreign excluded funds that meet the conditions included in the policy statement discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the policy statement. This section focuses on the seeding of RICs, because they are registered with the SEC (and applies to BDCs as well, which are regulated by the SEC). To the extent that the same considerations generally apply to the seeding of FPFs, the analysis below may be relevant for the seeding of these funds as well.[402]

[402] This section does not focus on foreign excluded funds. The information the SEC collects on Form ADV does not allow the SEC to estimate the number of SEC-registered investment advisers that advise foreign excluded funds. For example, Form ADV does not require advisers with a principal office and place of business outside the United States to provide information on Schedule D of Part 1A with respect to any private fund that, during the last fiscal year, was not a

The FAQ issued by the staffs related to seeding RICs and FPFs observed that the preamble to the 2013 final rule recognized that a banking entity may own a significant portion of the shares of a RIC or FPF during a brief period during which the banking entity is testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes, and attempting to distribute the fund's shares. The FAQ recognizes that the length of a seeding period can vary and therefore provides an example of 3 years, the maximum period of time that could be permitted under certain conditions for seeding a covered fund under the 2013 final rule, without setting any maximum prescribed period for a RIC or FPF seeding period. The Agencies are seeking comment on whether this guidance has been effective, including questions as to whether the Agencies should specify a maximum period of time for a seeding period or, conversely, whether the current approach of not prescribing a fixed period of time for a seeding period is more effective in providing flexibility for funds that may need more time to develop a track record without having to specify a particular time period that will be appropriate for all funds.

The SEC understands that RICs (and FPFs) commonly require some time to establish a performance track necessary to market the fund effectively to third-party investors. Some funds will need a 3-year performance track record, and sometimes longer, to be distributed through certain intermediaries or to attract sufficient investor interest. For example, the SEC understands that some funds might need a 5-year track record to be distributed effectively.

U.S. person, was not offered in the United States, and was not beneficially owned by any U.S. person. Because foreign excluded funds are organized and offered outside of the United States by foreign banking entities, however, many foreign excluded funds may be advised by foreign banks or other foreign affiliates or subsidiaries that are not SEC-registered investment advisers. Therefore, we preliminarily believe that the proposal and any further modifications to the 2013 final rule on which the Agencies seek comment would likely primarily impact foreign activities of foreign banking entities and funds outside of the SEC's regulatory oversight.

On the one hand, providing a fixed period of time beyond which a seeding period for a RIC cannot extend would provide banking entities with greater certainty, which may incentivize banking entities to form new funds. On the other hand, the current approach of not prescribing a fixed period of time for a seeding period for a RIC may provide flexibility for funds that need more time to develop a track record. This approach would recognize that banking entities may be able to quickly reduce a seed investment in some RICs but not in others. However, the lack of certainty about the length of permissible seeding period could disincentivize a banking entity from sponsoring a RIC.

Another potential approach, on which the Agencies seek comment, would be to specify a fixed period of time for a seeding period while also permitting a banking entity to hold an investment beyond this fixed period if the banking entity complies with additional conditions, such as documentation of the business need for the sponsor's continued investment. This may provide benefits by providing more certainty to banking entities, while providing for the ability to exceed a fixed seeding period in appropriate circumstances.

In addition, longer seeding periods for RICs and FPFs extend the period of time during which a banking entity may be subject to the risks associated with the seed investment. We note, however, that RICs are subject to all of the requirements under the Investment Company Act, and the exclusion for FPFs is designed to identify foreign funds that are sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition. Therefore, although section 13 and the 2013 final rule under certain conditions permit a seeding period of up to 3 years for covered funds (which are not subject to substantive SEC regulation and are the target of section 13's restrictions), longer seeding periods for RICs and FPFs may not raise the same concerns.

i. Compliance Program

i. Regulatory Baseline

The 2013 final rule emphasized the importance of a strong compliance program and sought to tailor the compliance program to the size of banking entities and the size of their trading activity. The Agencies believed it was necessary to balance compliance burdens posed on smaller banking entities with specificity and rigor necessary for large and complex banking organizations facing high compliance risks. As a result, the current compliance regime is progressively more stringent with the size of covered activities and/or balance sheet of banking entities.

Under the 2013 final rule, all banking entities with covered activities must develop and maintain a compliance program that is reasonably designed to ensure and monitor compliance with section 13 of the BHC Act and the implementing regulations. The terms, scope, and detail of the compliance program depend on the types, size, scope, and complexity of activities and business structure of the banking entity.[403] Under the 2013 final rule, banking entities with total consolidated assets of less than $10 billion as reported on December 31 of the 2 previous calendar years face a simplified compliance program: such entities are able to incorporate compliance with the 2013 final rule into their regular compliance policies and procedures by reference, adjusting as appropriate given the entities' activities, size, scope, and complexity.[404]

All other banking entities with covered activities are, at a minimum, required to implement a six-pillar compliance program. The six pillars include: (1) written policies and procedures reasonably designed to document, describe, monitor and limit proprietary trading and

[403] *See* 2013 final rule § __.20(a).

[404] *See* 2013 final rule § __.20(f). Note that if an entity does not have any covered activities, it is not required to establish a compliance program until it begins to engage in covered activity.

covered fund activities and investments for compliance; (2) a system of internal controls reasonably designed to monitor compliance; (3) a management framework that clearly delineates responsibility and accountability for compliance, including management review of trading limits, strategies, hedging activities, investments, and incentive compensation; 4) independent testing and audit of the effectiveness of the compliance program; 5) training for personnel to effectively implement and enforce the compliance program; and 6) recordkeeping sufficient to demonstrate compliance.[405]

In addition, under the 2013 final rule, banking entities with covered activities that do not qualify as those with modest activity (total consolidated assets in excess of $10 billion) and that either are subject to the reporting requirements of Appendix A or have more than $50 billion in gross consolidated total assets are required to comply with the enhanced minimum standards for compliance programs that are specified in Appendix B of the 2013 final rule.[406] That is, Appendix B scopes in (1) all banking entities with significant trading assets and liabilities; and (2) banking entities with covered activity that have more than $50 billion in gross consolidated total assets, regardless of whether or not these banking entities have significant trading assets and liabilities.

As described in greater detail elsewhere in the Supplementary Information, Appendix B requires the compliance program to (1) be reasonably designed to supervise the permitted trading and covered fund activities and investments, identify and monitor the risks of those activities and potential areas of noncompliance, and prevent prohibited activities and investments; (2) establish and enforce appropriate limits on the covered activities and investments, including limits on the

[405] *See* 2013 final rule § __.20(b).

[406] *See* 2013 final rule § __.20(c) and Appendix B.

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 final rule; 3) subject the compliance program to periodic independent review and testing and ensure the entity's internal audit, compliance, and internal control functions are effective and independent; 4) make senior management and others accountable for the effective implementation of the compliance program, and ensure that the chief executive officer and board of directors review the program; and 5) facilitate supervision and examination by the Agencies.

Additionally, under the 2013 final rule, any banking entity that has more than $10 billion in total consolidated assets as reported in the previous 2 calendar years shall maintain additional records in relation to covered funds. In particular, a banking entity must document the exclusions or exemptions relied on by each fund sponsored by the banking entity (including all subsidiaries and affiliates) in determining that such fund is not a covered fund, including documentation that supports such determination; for each seeding vehicle that will become a registered investment company or SEC-regulated business development company, a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company, the period of time during which the vehicle will operate as a seeding vehicle, and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified.[407]

The Agencies recognize that the scope and breadth of the compliance obligations impose significant costs on banking entities, which may be particularly impactful for smaller entities. For example, some commenters estimate that banking entities may have added as many as 2,500

[407] *See* 2013 final rule § __.20(e).

pages of policies, procedures, mandates, and controls per institution for the purposes of compliance with the 2013 final rule, which need to be monitored and updated on an ongoing basis.[408] Moreover, some banking entities may spend, on average, more than 10,000 hours on training each year.[409] In terms of ongoing costs, some banking entities may have 15 regularly meeting committees and forums, with as many as 50 participants per institution dedicated to compliance with the 2013 final rule.

The current compliance regime and related burdens may reduce the profitability of covered activities by dealers and investment advisers affiliated with banking entities and may be passed along to customers or clients in the form of reduced provision of services or higher service costs. Moreover, the Agencies recognize that the extensive compliance program under the 2013 final rule may detract resources of banking entities and their compliance departments and supervisors from other routine compliance matters, risk management, and supervision. Finally, prescriptive compliance requirements may not optimally reflect the organizational structures, governance mechanisms, or risk management practices of complex, innovative, and global banking entities.

ii. **Costs and Benefits**

The proposed amendments are expected to lower compliance burdens in two ways. First, the proposed amendments increase flexibility in complying with the 2013 final rule for banking entities without significant trading assets and liabilities, which may reduce compliance costs for these entities. Second, the proposed amendments streamline the compliance program for large banking entities. To the extent that current requirements are duplicative and maintaining both an enhanced compliance program and regular compliance systems is inefficient, large entities may

[408] *See supra* note 18.

[409] *Id.*

benefit from the proposed amendments. Specifically, the proposed amendments introduce four main changes to the compliance program requirements of the 2013 final rule.

First, Group C entities would be subject to presumed compliance with proprietary trading and covered fund prohibitions. Specifically, the rebuttable presumption of compliance would apply to all holding companies with less than $1 billion in combined total of consolidated trading assets and trading liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States). We preliminarily estimate that approximately 42 broker-dealers would be able to avail themselves of the rebuttable presumption and would not have to apply the 2013 final rule's compliance program requirements. The presumed compliance standard proposed for Group C entities may benefit entities with very low levels of trading activity by providing additional compliance flexibility. While this may increase the risks of non-compliance, the proposed amendments do not waive the proprietary trading and covered fund prohibitions of the 2013 final rule for such entities.

Second, the threshold for a simplified compliance program would be based on a banking entity's consolidated trading assets and liabilities instead of its total assets. The Agencies recognize that existing compliance program requirements may burden entities that engage in little covered trading activity but have larger total assets. The proposed amendment may reduce costs for banking entities that have more than $10 billion in total assets but do not have significant trading activity. Since the volume of consolidated trading assets and liabilities is likely less than the size of the firm's balance sheet, this amendment would scope in more holding companies—and consequently SEC-registered dealers and investment advisers affiliated with them—into the simplified compliance program regime.

Third, under the proposed amendments covered fund recordkeeping requirements apply to banking entities with significant trading assets and liabilities, rather than to banking entities with over $10 billion in total assets. As discussed above, the Agencies expect that the covered funds activities of banking entities without significant trading assets and liabilities may generally be smaller in scale and less complex than those of banking entities with significant trading assets and liabilities. Thus, the value of additional documentation requirements for banking entities without significant trading assets and liabilities may be lower. The proposal reflects these considerations and may reduce the costs associated with these covered funds recordkeeping requirements by reducing the number of banking entities subject to these requirements.[410] We note that entities with moderate trading assets and liabilities would still be required to comply with all the covered fund provisions, and the proposal simply eliminates recordkeeping for the purposes of demonstrating compliance. While, in general, the removal of such recordkeeping requirements may reduce the effectiveness of regulatory oversight, we preliminarily believe that SEC oversight of registered dealers and investment advisers of covered funds may not be adversely affected.

Fourth, with an exception for the CEO attestation, the requirements in Appendix B of the 2013 final rule would be removed. The Agencies understand that compliance with Appendix B required entities to develop and administer an enhanced compliance program that may not be tailored to the business model or risks of specific institutions. Further, some banking entities

[410] We do not have the information necessary to quantify the current costs of compliance programs specific to banking entity RIAs. Thus, we do not allocate cost savings from monetized PRA burdens to banking entity RIAs from the proposed Appendix B amendments. To the degree that some banking entity RIAs may be complying using compliance resources and systems independent of the affiliated holding company or affiliates and subsidiaries, we may be underestimating the cost savings from the proposed amendments.

have established as many as 500 controls related to Appendix B obligations, some of which may be duplicating existing policies and procedures designed as part of prudential safety and soundness.[411] The removal of Appendix B requirements will affect all Group A banking entities and Group B and Group C banking entities that have total consolidated assets of $50 billion or more. We estimate that there are 100 broker-dealers that may experience reduced compliance costs as a result of this amendment. The removal of the Appendix B requirements may significantly reduce the number and complexity of the compliance requirements such entities are subject to. Given the size of affected holding companies, a stringent compliance regime may reduce compliance risks related to the substantive prohibition of the 2013 final rule. However, Group A and Group B entities will continue to be required to establish and maintain a compliance program under § __.20.

Finally, the proposed amendment would require all Group A and Group B entities to comply with the CEO attestation requirement. Under the 2013 final rule, banking entities with $50 billion or more in total consolidated assets, banking entities with over $10 billion in consolidated trading assets and liabilities, and those banking entities that an Agency has notified in writing are subject to the CEO attestation requirement.[412] We estimate that currently as many as 100 banking entity broker-dealers are required to comply with the CEO attestation requirement. Based on the counts in Table 2, we estimate that the proposed amendment will reduce this number to approximately 96 entities. However, we recognize that entities have flexibility to comply with the attestation requirement, including providing it at the SEC-

[411] *See supra* note 18.

[412] As a baseline matter, the CEO is currently required to annually attest that the banking entity has in place processes to establish, maintain, enforce, review, test, and modify the compliance program established pursuant to Appendix B in a manner reasonably designed to achieve compliance with section 13 of the BHC Act and the 2013 final rule.

registrant or at the holding-company level. For example, in 2017 the SEC received a total of 57 attestations, including those from registrants and holding companies. While the proposed amendment may slightly decrease the number of affected broker-dealers because of this flexibility in compliance, the effects on compliance burdens for SEC registrants, if any, are unclear.

As an alternative, the Agencies could have proposed amending the 2013 final rule by requiring CEO attestations for all Group A entities only if they have over $50 billion in total assets; removing the CEO attestation requirement; or allowing other senior officers, such as the chief compliance officer (CCO), to provide the requisite attestation for some or all affected banking entities. The Agencies recognize that the CEO attestation process is costly and that some banking entities may spend more than 1,700 hours on the CEO attestation process and that the elimination of this requirement may reduce time dedicated towards the compliance program by as much as 10%.[413] The Agencies also recognize that allowing other senior officers to provide the attestation would provide beneficial flexibility to banking entities with different business models, organizational structures, delegation of duties, and internal reporting and oversight lines. In addition, as the Agencies have discussed in other contexts,[414] certification and attestation requirements may increase CEO liability when the CEO executes the required attestation. If CEOs of banking entities are risk averse, they may require additional liability insurance, higher compensation or lower incentive pay as a fraction of overall compensation. However, liability related to the attestation may also serve as a disciplining mechanism by

[413] *See supra* note 18.

[414] *See*, *e.g.*, Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 77617 (Apr. 13, 2016), 81 FR 29960, 30128 (May 24, 2016).

incentivizing compliance and may reduce risk-taking by banking entities. We also note that the covered activities of larger and more complex banking entities with higher volumes of trading activity may involve more significant moral hazard and conflicts of interest.

The Agencies also recognize that CEO attestation may be costly for foreign banking entities. For example, one foreign firm reported that it organizes and manages a global controls sub-certification process that takes 6 months to complete and involves over 400 staff (including over 260 outside the United States) in order for the CEO to sign and deliver the annual attestation.[415] As an alternative, the Agencies could have proposed exempting foreign banking entities from the CEO attestation requirement. Currently, the requirement covers only the U.S. operations of a foreign banking entity and not its foreign operations. Similar to the analysis of the proposed amendment to trading outside the United States, this alternative may decrease compliance costs and increase trading activity by foreign banking entities in the United States, but result in losses in market share and profitability for U.S. banking entities that would remain subject to the attestation requirement and would be placed at a competitive disadvantage as a result.

As can be seen from section V.B, the Agencies do not estimate any recordkeeping or reporting burden reductions related to compliance requirements in § __.20(b) of the final rule. The proposed removal of Appendix B requirements will result in ongoing annual cost savings estimated as $8,098,200 for registered broker-dealers and as up to $2,753,388 for entities that may choose to register as SBSDs.[416] In addition, the removal of Appendix B requirements may

[415] *See supra* note 18.

[416] Cost reduction for broker-dealers: 1,100 hours per firm x 0.18 dealer weight x 100 broker-dealers x (Attorney at $409 per hour) = $8,098,200. Cost reductions for entities that may register as SBSDs may be as high as: 1,100 hours per firm x 0.18 dealer weight x 34 firms x (Attorney at

result in initial cost savings estimated as $24,294,600 for registered broker-dealers, and up to $8,260,164 for entities that may choose to register as SBSDs.[417] As can be seen from section V.B, the Agencies do not estimate any recordkeeping or reporting burden reductions related to proposed presumed compliance amendment in § __.20(f)(2) of the final rule.

iii. **Competition, Efficiency, and Capital Formation**

Under the proposed amendments, both Group A and Group B entities will enjoy reduced compliance program requirements and Group C will be presumed compliant with prohibitions of sections B and C of the proposed rule. To the extent that compliance program requirements for Group B entities are less costly, Group A entities close to the threshold may choose to manage down their trading book such that they would qualify for the simplified compliance program, resulting in more competition among entities that are close to the threshold. Similarly, the proposed amendment may incentivize Group B entities close to the threshold to rebalance their trading book and qualify for the presumed compliance treatment of Group C entities. Such management of the trading book may reduce the risk of each individual banking entity and may decrease moral hazard addressed by the 2013 final rule. We note that entities are likely to weigh potential cost savings related to lighter compliance requirements for Group B and Group C entities against the costs of reducing trading activity below the $10 billion and $1 billion thresholds. Therefore, this competition effect may be particularly significant for Group A

$409 per hour) = $2,753,388. The estimate for SBSDs assumes that all 34 SBSDs would be subject to Appendix B requirements, and may over-estimate the cost savings.

[417] Initial set-up cost reduction for broker-dealers: 3,300 hours per firm x 0.18 dealer weight x 100 broker-dealers x (Attorney at $409 per hour) = $24,294,600. Cost reductions for entities that may register as SBSDs may be as high as: 3,300 hours per firm x 0.18 dealer weight x 34 firms x (Attorney at $409 per hour) = $8,260,164. The estimate for SBSDs assumes that all 34 SBSDs would be subject to Appendix B requirements, and may over-estimate the cost savings.

entities that are close to the $10 billion threshold and for Group B entities that are close to the $1 billion threshold.

Since the compliance requirements do not impact the scope of information available to investors, we do not anticipate effects on informational efficiency to be significant. To the extent that some dealers are experiencing large compliance costs and partially or fully passing them along to customers in the form of reduced access to capital or higher cost of capital, the amendment may reduce costs of and increase access to capital.

4. Request for Comment

The SEC is requesting comment regarding the economic analysis set forth here. To the extent possible, the SEC requests that market participants and other commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed amendments or any reasonable alternatives. In addition, the SEC asks commenters to consider the following questions:

Question SEC-1. What additional qualitative or quantitative information should the SEC consider as part of the baseline for its economic analysis of the proposed amendments?

Question SEC-2. What additional considerations can the SEC use to estimate the costs and benefits of implementing the proposed amendments for SEC-regulated banking entities?

Question SEC-3. Is it likely that certain cost savings associated with the proposed rule will not be recognized by SEC-regulated banking entities because of the nature of their activities or because of new costs the proposal would impose on these activities? Why or why not? Are there other benefits or costs associated with the proposed rule that will impact SEC-regulated banking entities differently than other types of banking entities?

Question SEC-4. Has the SEC considered all relevant aspects of the proposed amendments? Are the estimated costs of the proposed rule for SEC-regulated banking entities reasonable? If not, please explain in detail why the cost estimates should be higher or lower than those provided. Have we accurately described the benefits of the proposed rule? Why or why not? Please identify any other benefits associated with the proposed rule in detail. Please identify any costs associated with the proposed rule that we have not identified.

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

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons stated in the Common Preamble, the Office of the Comptroller of the Currency proposes to amend chapter I of Title 12, Code of Federal Regulations as follows:

PART 44 PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

■ 1. The authority citation for part 44 continues to read as follows:

Authority: 7 U.S.C. 27 et seq., 12 U.S.C. 1, 24, 92a, 93a, 161, 1461, 1462a, 1463, 1464, 1467a, 1813(q), 1818, 1851, 3101 3102, 3108, 5412.

■ 2. Section 44.2 is revised to read as follows:

§ 44.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the OCC determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(c) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(d) *Banking entity.* (1) Except as provided in paragraph (d)(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 (d)(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 (d)(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 (d)(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.

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *CFTC* means the Commodity Futures Trading Commission.

(g) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(h) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(i) *Derivative.* (1) Except as provided in paragraph (i)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(j) *Employee* includes a member of the immediate family of the employee.

(k) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(l) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(m) *FDIC* means the Federal Deposit Insurance Corporation.

(n) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(o) *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.

(p) *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.

(q) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(r) *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).

(s) *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 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)).

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

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1,000,000,000; and

(2) The OCC has not determined pursuant to § 44.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(u) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(v) *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.

(w) *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)).

(x) *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.

(y) *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)).

(z) *SEC* means the Securities and Exchange Commission.

(aa) *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.

(bb) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(cc) *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)).

(dd) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(ee) *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.

(ff) *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 $10,000,000,000; or

(ii) The OCC has determined pursuant to § 44.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (3), trading assets and liabilities for purposes of this paragraph (ff) means trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff) means the trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff)(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.

(gg) *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.

(hh) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ii) *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.

(jj) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

3. Section 44.3 is amended by:

a. Revising paragraph (b);

b. Redesignating paragraphs (c) through (e) as paragraphs (d) through (f);

c. Adding a new paragraph (c);

d. Revising paragraph (e)(3) and adding paragraph (e)(10);

e. Redesignating paragraphs (f)(5) through (f)(13) as paragraphs (f)(6) through (f)(14) and adding new paragraph (f)(5); and

f. Adding paragraph (g).

The revisions and additions read as follows:

§ 44.3. Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account*. *Trading account* means any account that is used by a banking entity to:

(1)(i) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(ii) With respect to 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, purchase or sell one or more financial instruments that are subject to 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, as amended from time to time.

(2) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(i) 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

(ii) 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; or

(3) Purchase or sell one or more financial instruments, with respect to a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards.

(c) *Presumption of compliance*. (1)(i) Each trading desk that does not purchase or sell financial instruments for a trading account defined in paragraphs (b)(1) or (b)(2) of this section may calculate the net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

(ii) If the sum of the absolute values of the daily net gain and loss figures determined in accordance with paragraph (c)(1)(i) of this section for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk shall be presumed to be in compliance with the prohibition in paragraph (a) of this section.

(2) The OCC may rebut the presumption of compliance in paragraph (c)(1)(ii) of this section by providing written notice to the banking entity that the OCC has determined that one or more of the banking entity's activities violates the prohibitions under subpart B.

(3) If a trading desk operating pursuant to paragraph (c)(1)(ii) of this section exceeds the $25 million threshold in that paragraph at any point, the banking entity shall, in accordance with any policies and procedures adopted by the OCC:

(i) Promptly notify the OCC;

(ii) Demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B; and

(iii) Demonstrate, with respect to the trading desk, how the banking entity will maintain compliance with subpart B on an ongoing basis.

* * * * *

(e) * * *

(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 physically-settled 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, with respect to such financial instruments:

(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 instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under §§ 44.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (e)(3) of this section; and

(vi) Is consistent with the OCC's supervisory requirements, guidance, and expectations 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, and the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.

(f) * * *

(5) *Cross-currency swa*p 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.

* * * * *

(g) *Reservation of Authority*: (1)The OCC may determine, on a case-by-case basis, that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account as defined at 12 U.S.C. 1851(h)(6).

(2) *Notice and Response Procedures*. -- (i) *Notice*. When the OCC determines that the purchase or sale of one or more financial instruments is for the trading account under paragraph (g)(1) of this section, the OCC will notify the banking entity in writing of the determination and provide an explanation of the determination.

(ii) *Response*. (A) The banking entity may respond to any or all items in the notice. The response should include any matters that the banking entity would have the OCC consider in deciding whether the purchase or sale is for the trading account. The response must be in writing and delivered to the designated OCC official within 30 days after the date on which the banking entity received the notice. The OCC may shorten the time period when, in the opinion of the OCC, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the OCC may extend the time period for good cause.

(B) Failure to respond within 30 days or such other time period as may be specified by the OCC shall constitute a waiver of any objections to the OCC's determination.

(iii) After the close of banking entity's response period, the OCC will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the OCC's determination that the purchase or sale of one or more financial instruments is for the trading account. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

4. Section 44.4 is amended by:

a. Revising paragraph (a)(2);

b. Adding paragraph (a)(8);

c. Revising paragraph (b)(2);

d. Revising the introductory text of paragraph (b)(3)(i);

e. In paragraph (b)(5) removing "*inventory*" wherever it appears and adding "*positions*" in its place; and

f. Adding a new paragraph (b)(6).

The revisions and additions read as follows:

§ 44.4. Permitted underwriting and market making-related activities.

(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 type of security, 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 type of security;

(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)(8)(i) of this section;

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

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

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

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

* * * * *

(8) *Rebuttable presumption of compliance.* -- (i) *Risk limits*. (A) A banking entity shall be presumed to meet the requirements of paragraph (a)(2)(ii)(A) 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 limits described in paragraph (a)(8)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (8)(i)(A) of this section shall be available with respect to limits for each trading desk 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.

(ii) *Supervisory review and oversight*. The limits described in paragraph (a)(8)(i) of this section shall be subject to supervisory review and oversight by the OCC on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (a)(8)(i) of this section, a banking entity shall promptly report to the OCC (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the OCC.

(iv) *Rebutting the presumption*. The presumption in paragraph (a)(8)(i) of this section may be rebutted by the OCC if the OCC determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The OCC will provide notice of any such determination to the banking entity in writing.

(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, based on the liquidity, maturity, and depth of the market for the relevant types of financial instrument(s).

(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)(6)(i) of this section;

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

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

(iv) In the case of a banking entity with significant trading assets and liabilities, to the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

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

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) * * *

(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 definition of "significant trading assets and liabilities" contained in § 44.2 of this part, unless:

* * * * *

(6) *Rebuttable presumption of compliance.*

(i) *Risk limits.*

(A) A banking entity shall be presumed to meet the requirements of paragraph (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 limits described in paragraph (b)(6)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (6)(i)(A) of this section shall be available with respect to limits for each trading desk 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, on the:

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

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

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

(*4*) Period of time a financial instrument may be held.

(ii) *Supervisory review and oversight*. The limits described in paragraph (b)(6)(i) of this section shall be subject to supervisory review and oversight by the OCC on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (b)(6)(i) of this section, a banking entity shall promptly report to the OCC (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s) , in each case in the form and manner as directed by the OCC.

(iv) *Rebutting the presumption*. The presumption in paragraph (b)(6)(i) of this section may be rebutted by the OCC if the OCC determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The OCC will provide notice of any such determination to the banking entity in writing.

5. Section 44.5 is amended by revising paragraphs (b) and (c)(1) introductory text and adding paragraph (c)(4) to read as follows:

§ 44.5. Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements*.

(1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C)Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking

entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * * (1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The hedging limits shall be appropriate for the:

(A) Size, types, and risks of the hedging activities commonly undertaken by the trading desk;

(B) Financial instruments purchased and sold for hedging activities by the trading desk; and

(C) Levels and duration of the risk exposures being hedged.

6. Section 44.6 is amended by revising paragraph (e)(3) and removing paragraph (e)(6) to read as follows:

§ 44.6. Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

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

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

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

* * * * *

§ 44.10 [Amended]

7. Section 44.10 is amended by:

a. In paragraph (c)(8)(i)(A) removing "§ 44.2(s)" and adding "§ 44.2(u)" in its place;

b. Removing paragraph (d)(1);

c. Redesignating paragraphs (d)(2) through (d)(10) as paragraphs (d)(1) through (d)(9);

d. In paragraph (d)(5)(i)(G) revising the reference to "(d)(6)(i)(A)" to read "(d)(5)(i)(A)"; and

e. In paragraph (d)(9) revising the reference to "(d)(9)" to read "(d)(8)" and the reference to "(d)(10)(i)(A)" to read "(d)(9)(i)(A)" and the reference to "(d)(10)(i)" to read "(d)(9)(i)".

8. Section 44.11 is amended by revising paragraph (c) as follows:

§ 44.11. Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 44.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 44.4(a) or § 44.4(b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*-11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78*o*-11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are

included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 44.12(a)(2)(ii); § 44.12(a)(2)(iii), and § 44.12(d) of this subpart.

9. Section 44.12 is amended by:

a. In paragraphs (c)(1) and (d) removing "§ 44.10(d)(6)(ii)" and adding "§ 44.10(d)(5)(ii)" in its place;

b. Removing paragraph (e)(2)(vii); and

c. Redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

10. Section 44.13 is amended by revising paragraphs (a) and (b)(3) and removing paragraph (b)(4)(iv) to read as follows:

§ 44.13. Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 44.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) *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.

* * * * *

11. Section 44.14 is amended by revising paragraph (a)(2)(ii)(B) as follows:

§ 44.14. Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the OCC (with a duty to update the certification if the information in the certification materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and

* * * * *

12. Section 44.20 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) and (h).

The revisions read as follows:

§ 44.20. Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities*. With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation*.

(1) The CEO of a banking entity described in paragraph (2) must, based on a review by the CEO of the banking entity, attest in writing to the OCC, each year no later than March 31, that the banking entity has in place processes 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.

(2) The requirements of paragraph (c)(1) apply to a banking entity if:

(i) The banking entity does not have limited trading assets and liabilities; or

(ii) The OCC notifies the banking entity in writing that it must satisfy the requirements contained in paragraph (c)(1).

(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 OCC notifies the banking entity in writing that it must satisfy the reporting requirements contained in the Appendix.

(2) Frequency of reporting: Unless the OCC notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with the methodology described in the definition of "significant trading assets and liabilities" contained in § 44.2 of this part of this part) shall report the information required by the Appendix for each calendar month within 20 days of the end of each calendar month. Any other banking entity subject to the Appendix shall report the

information required by the Appendix for each calendar quarter within 30 days of the end of that calendar quarter unless the OCC notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* 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*. (i) If upon examination or audit, the OCC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C, the OCC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities.

(ii) Notice and Response Procedures. (A) Notice. The OCC will notify the banking entity in writing of any determination pursuant to paragraph (g)(2)(i) of this section to rebut the presumption described in this paragraph (g) and will provide an explanation of the determination.
(B) Response. (*1*) The banking entity may respond to any or all items in the notice described in paragraph (g)(2)(ii)(A) of this section. The response should include any matters that the banking entity would have the OCC consider in deciding whether the banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The response must be in writing and delivered to the designated OCC official within 30 days after the date on which the banking entity received the notice. The OCC may shorten the time period when, in the opinion of the OCC, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the OCC may extend the time period for good cause.
(*2*) Failure to respond within 30 days or such other time period as may be specified by the OCC shall constitute a waiver of any objections to the OCC's determination.
(C) After the close of banking entity's response period, the OCC will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the OCC's determination that banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.
(h) *Reservation of authority.* Notwithstanding any other provision of this part, the OCC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the OCC determines that the size or complexity of the

banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C, 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.

13. Remove Appendix A and Appendix B to Part 44 and add Appendix to Part 44—Reporting and Recordkeeping Requirements for Covered Trading Activities

Appendix to Part 44—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B ("proprietary trading restrictions"). Pursuant to § 44.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the OCC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 44.20.

b. The purpose of this appendix is to assist banking entities and the OCC in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 44.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 44.4, 44.5, or 44.6(a)-(b) (i.e., underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the OCC of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 44.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments

traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 44.4 through 44.6(a)-(b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the OCC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 44.2 and 44.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 44.4, 44.5, 44.6(a), or 44.6(b). A banking entity may include in its covered trading activity trading conducted under §§ 44.3(e), 44.6(c), 44.6(d), or 44.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. *Quantitative measurements*. Each banking entity made subject to this appendix by § 44.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Risk and Position Limits and Usage;

ii. Risk Factor Sensitivities;

iii. Value-at-Risk and Stressed Value-at-Risk;

iv Comprehensive Profit and Loss Attribution;

v. Positions;

vi. Transaction Volumes; and

vii. Securities Inventory Aging.

2. *Trading desk information*. Each banking entity made subject to this appendix by § 44.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. *Quantitative measurements identifying information*. Each banking entity made subject to this appendix by § 44.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. *Narrative statement*. Each banking entity made subject to this appendix by § 44.20 must provide a separate narrative statement, as further described in this appendix.

5. *File identifying information*. Each banking entity made subject to this appendix by § 44.20 must provide file identifying information in each submission to the OCC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. *Trading Desk Information*

1. Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

i. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;

ii. Identification of each type of covered trading activity in which the trading desk is engaged;

iii. Brief description of the general strategy of the trading desk;

iv. A list of the types of financial instruments and other products purchased and sold by the trading desk; an indication of which of these are the main financial instruments or

products purchased and sold by the trading desk; and, for trading desks engaged in market making-related activities under § 44.4(b), specification of whether each type of financial instrument is included in market-maker positions or not included in market-maker positions. In addition, indicate whether the trading desk is including in its quantitative measurements products excluded from the definition of "financial instrument" under § 44.3(d)(2) and, if so, identify such products;

v.. Identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and indication of which of the identified legal entities are the main booking entities for covered trading activities of the trading desk;

vi. For each legal entity that serves as a booking entity for covered trading activities, specification of any of the following applicable entity types for that legal entity:

A. National bank, Federal branch or Federal agency of a foreign bank, Federal savings association, Federal savings bank;

B. State nonmember bank, foreign bank having an insured branch, State savings association;

C. U.S.-registered broker-dealer, U.S.-registered security-based swap dealer, U.S.-registered major security-based swap participant;

D. Swap dealer, major swap participant, derivatives clearing organization, futures commission merchant, commodity pool operator, commodity trading advisor, introducing broker, floor trader, retail foreign exchange dealer;

E. State member bank;

F. Bank holding company, savings and loan holding company;

G. Foreign banking organization as defined in 12 CFR 211.21(o);

H. Uninsured State-licensed branch or agency of a foreign bank; or

I. Other entity type not listed above, including a subsidiary of a legal entity described above where the subsidiary itself is not an entity type listed above;

vii Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and

viii. Currency reported and daily currency conversion rate.

c. *Quantitative Measurements Identifying Information*

1. Each banking entity must provide the following information regarding the quantitative measurements:

i. A Risk and Position Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit;

ii. A Risk Factor Sensitivities Information Schedule that provides identifying and descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement, including the name of the sensitivity, a unique identification label for the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit;

iii. 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;

iv. A Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule; and

v. A Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

d. ***Narrative Statement***

1. Each banking entity made subject to this appendix by § 44.20 must submit in a separate electronic document a Narrative Statement to the OCC describing any changes in calculation methods used, a description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement must include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used.

2. If a banking entity does not have any information to report in a Narrative Statement, the banking entity must submit an electronic document stating that it does not have any information to report in a Narrative Statement.

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 Narrative Statement, the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the OCC on the reporting schedule established in § 44.20 unless otherwise requested by the OCC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the OCC in accordance with the XML Schema specified and published on the OCC's website.

f. *Recordkeeping*

A banking entity must, for any quantitative measurement furnished to the OCC pursuant to this appendix and § 44.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the OCC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the OCC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Risk and position

limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in § 44.4 and § 44.5. A number of the metrics that are described below, including "Risk Factor Sensitivities" and "Value-at-Risk," relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market making activities under § 44.4(b) and hedging activity under § 44.5. Accordingly, the limits required under § 44.4(b)(2)(iii) and § 44.5(b)(1)(i)(A) must meet the applicable requirements under § 44.4(b)(2)(iii) and § 44.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, the "Risk Factor Sensitivities" and "Value-at-Risk" metrics except to the extent any of the "Risk Factor Sensitivities" or "Value-at-Risk" metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

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 Risk and Position 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. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and

risk. A banking entity must report the risk factor sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. Reported risk factor sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings. A banking entity must provide the following information for each sensitivity that is reported pursuant to this quantitative measurement: the unique identification label for the risk factor sensitivity listed in the Risk Factor Sensitivities Information Schedule, the change in risk factor used to determine the risk factor sensitivity, and the aggregate change in value across all positions of the desk given the change in risk factor.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

3. Value-at-Risk and Stressed 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. For purposes of this appendix, Stressed Value-at-Risk ("Stressed 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 market conditions during a period of significant financial stress.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: For VaR, all trading desks engaged in covered trading activities. For Stressed VaR, all trading desks engaged in covered trading activities, except trading desks whose covered

trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument" under § 44.3(d)(2).

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day.

The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. 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 that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

c. *Positions, Transaction Volumes, and Securities Inventory Aging 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."[418] A banking entity must separately report the trading desk's market value of long securities positions, market value of short securities positions, market value of derivatives receivables, market value of derivatives payables, notional value of derivatives receivables, and notional value of derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 44.4(a) or § 44.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description*: For purposes of this appendix, Transaction Volumes measures four 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; (iii) trading desks and other organizational units where the transaction is booked in the same banking entity; and (iv) trading desks and other organizational units where the transaction is booked into an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[419] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a

[418] *See* §§ 44.2(i), (bb). 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.

[419] *See* §§ 44.2(i), (bb).

trading desk that relies on § 44.4(a) to conduct underwriting activity is a market participant identified in § 44.4(a)(7), and a customer of a trading desk that relies on § 44.4(b) to conduct market making-related activity is a market participant identified in § 44.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 44.4(a) or § 44.4(b) to conduct underwriting activity or market-making-related activity, respectively.

3. Securities Inventory Aging

i. *Description:* For purposes of this appendix, Securities Inventory Aging generally describes a schedule of the market value of the trading desk's securities positions and the amount of time that those securities positions have been held. Securities Inventory Aging must measure the age profile of a trading desk's securities positions for the following 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. Securities Inventory Aging includes two schedules, a security asset-aging schedule, and a security liability-aging schedule. For purposes of the Securities Inventory Aging quantitative measurement, do not include securities that are also "derivatives," as those terms are defined under subpart A.[420]

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 44.4(a) or § 44.4(b) to conduct underwriting activity or market-making related activity, respectively.

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[420] *See* §§ 44.2(i), (bb).

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the Common Preamble the Board proposes to amend chapter II of title 12 of the Code of Federal Regulations as follows:

PART 248—PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS (Regulation VV)

14. 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

15. Section 248.2 is revised 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) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the [Agency] determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(c) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(d) *Banking entity.* (1) Except as provided in paragraph (d)(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 (d)(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 (d)(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 (d)(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.

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *CFTC* means the Commodity Futures Trading Commission.

(g) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(h) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(i) *Derivative.* (1) Except as provided in paragraph (i)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(j) *Employee* includes a member of the immediate family of the employee.

(k) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(l) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(m) *FDIC* means the Federal Deposit Insurance Corporation.

(n) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(o) *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.

(p) *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.

(q) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(r) *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).

(s) *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 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)).

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

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1,000,000,000; and

(2) 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.

(u) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(v) *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.

(w) *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)).

(x) *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.

(y) *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)).

(z) *SEC* means the Securities and Exchange Commission.

(aa) *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.

(bb) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(cc) *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)).

(dd) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(ee) *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.

(ff) *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 $10,000,000,000; 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), trading assets and liabilities for purposes of this paragraph (ff) means trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff) means the trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff)(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.

(gg) *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.

(hh) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ii) *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.

(jj) *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

16. Amend § 248.3 by:

a. Revising paragraph (b);

b. Redesignating paragraphs (c) through (e) as paragraphs (d) through (f);

c. Adding a new paragraph (c);

d. Revising paragraph (e)(3);

e. Adding paragraph (e)(10);

f. Redesignating paragraphs (f)(5) through (f)(13) as paragraphs (f)(6) through (f)(14);

g. Adding a new paragraph (f)(5); and

h. Adding a new paragraph (g).

The revisions and additions read as follows:

§ 248.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account*. *Trading account* means any account that is used by a banking entity to:

(1)(i) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(ii) With respect to 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, purchase or sell one or more financial instruments that are subject to 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, as amended from time to time.

(2) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(i) 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

(ii) 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; or

(3) Purchase or sell one or more financial instruments, with respect to a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards.

(c) *Presumption of compliance*. (1)(i) Each trading desk that does not purchase or sell financial instruments for a trading account defined in paragraphs (b)(1) or (b)(2) of this section may calculate the net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

(ii) If the sum of the absolute values of the daily net gain and loss figures determined in accordance with paragraph (c)(1)(i) of this section for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk shall be presumed to be in compliance with the prohibition in paragraph (a) of this section.

(2) The Board may rebut the presumption of compliance in paragraph (c)(1)(ii) of this section by providing written notice to the banking entity that the Board has determined that one or more of the banking entity's activities violates the prohibitions under subpart B.

(3) If a trading desk operating pursuant to paragraph (c)(1)(ii) of this section exceeds the $25 million threshold in that paragraph at any point, the banking entity shall, in accordance with any policies and procedures adopted by the Board:

(i) Promptly notify the Board;

(ii) Demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B; and

(iii) Demonstrate, with respect to the trading desk, how the banking entity will maintain compliance with subpart B on an ongoing basis.

* * * * *

(e) * * *

(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 physically-settled 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, with respect to such financial instruments:

(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 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 (e)(3) of this section; and

(vi) Is consistent with the Board's supervisory requirements, guidance, and expectations 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, and the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.

(f) * * *

(5) *Cross-currency swa*p 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.

* * * * *

(g) *Reservation of Authority*: (1)The Board may determine, on a case-by-case basis, that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account as defined at 12 U.S.C. 1851(h)(6).

(2) Notice and Response Procedures.

(i) Notice. When the Board determines that the purchase or sale of one or more financial instruments is for the trading account under paragraph (g)(1) of this section, the Board will notify the banking entity in writing of the determination and provide an explanation of the determination.

(ii) Response.

(A) The banking entity may respond to any or all items in the notice. The response should include any matters that the banking entity would have the Boardconsider in deciding whether the purchase or sale is for the trading account. 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 promptly of the new time period, or with the consent of the banking entity. In its discretion, the Board may extend the time period for good cause.

(B) 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.

(iii) After the close of banking entity's response period, the Board will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the Board's determination that the purchase or sale of one or more financial instruments is for the trading account. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

17. Section 248.4 is amended by:

a. Revising paragraph (a)(2);

b. Adding paragraph (a)(8);

c. Revising paragraph (b)(2);

d. Revising the introductory language of paragraph (b)(3)(i);

e. In paragraph (b)(5) revising the references to "*inventory*" to read "*positions*"; and

f. Adding a new paragraph (b)(6).

The revisions and additions read as follows:

The revisions and additions read as follows:

§ 248.4. Permitted underwriting and market making-related activities.

(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 type of security, 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 type of security;

(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)(8)(i) of this section;

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

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

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

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

* * * * *

(8) *Rebuttable presumption of compliance*. -- (i) *Risk limits*. (A) A banking entity shall be presumed to meet the requirements of paragraph (a)(2)(ii)(A) 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 limits described in paragraph (a)(8)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (8)(i)(A) of this section shall be available with respect to limits for each trading desk 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.

(ii) *Supervisory review and oversight*. The limits described in paragraph (a)(8)(i) of this section shall be subject to supervisory review and oversight by the Board on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (a)(8)(i) of this section, a banking entity shall promptly report to the Board (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the Board.

(iv) *Rebutting the presumption*. The presumption in paragraph (a)(8)(i) of this section may be rebutted by the Board if the Board determines, 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 will provide notice of any such determination to the banking entity in writing.

(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, based on the liquidity, maturity, and depth of the market for the relevant types of financial instrument(s).

(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)(6)(i) of this section;

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

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

(iv) In the case of a banking entity with significant trading assets and liabilities, to the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

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

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) * * *

(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 definition of "significant trading assets and liabilities" contained in § 248.2 of this part, unless:

* * * * *

(6) *Rebuttable presumption of compliance.*

(i) *Risk limits*.

(A) A banking entity shall be presumed to meet the requirements of paragraph (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 limits described in paragraph (b)(6)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (6)(i)(A) of this section shall be available with respect to limits for each trading desk 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, on the:

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

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

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

(*4*) Period of time a financial instrument may be held.

(ii) *Supervisory review and oversight*. The limits described in paragraph (b)(6)(i) of this section shall be subject to supervisory review and oversight by the Board on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (b)(6)(i) of this section, a banking entity shall promptly report to the Board (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s) , in each case in the form and manner as directed by the Board.

(iv) *Rebutting the presumption*. The presumption in paragraph (b)(6)(i) of this section may be rebutted by the Board if the Board determines, 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 will provide notice of any such determination to the banking entity in writing.

18. Amend § 248.5 by revising paragraph (b), the introductory text of paragraph (c)(1); and adding paragraph (c)(4) to read as follows:

§ 248.5. Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements*.

(1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C) Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * * (1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The hedging 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.

19. Amend **§** 248.6 by revising paragraph (e)(3) and removing paragraph (e)(6) 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

§ 248.10 [Amended]

20. Section 248.10 is amended by:

a. In paragraph (c)(8)(i)(A) revising the reference to "§ 248.2(s)" to read "§ 248.2(u)";

b. Removing paragraph (d)(1);

c. Redesignating paragraphs (d)(2) through (d)(10) as paragraphs (d)(1) through (d)(9);

d. In paragraph (d)(5)(i)(G) revising the reference to "(d)(6)(i)(A)" to read "(d)(5)(i)(A)"; and

e. In paragraph (d)(9) revising the reference to "(d)(9)" to read "(d)(8)" and the reference to "(d)(10)(i)(A)" to read "(d)(9)(i)(A)" and the reference to "(d)(10)(i)" to read "(d)(9)(i)"

21. Section 248.11 is amended by revising paragraph (c) 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)

22. Section 248.12 is amended by

a. In paragraphs (c)(1) and (d) removing the references to "§ 248.10(d)(6)(ii)" and replacing with "§ 248.10(d)(5)(ii)";

b. Removing paragraph (e)(2)(vii); and

c. Redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

23. Section 248.13 is amended by revising paragraphs (a) and (b)(3) 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.

* * * * *

24. Section 248.14 is amended by revising paragraph (a)(2)(ii)(B) 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

25. Section 248.20 is amended by:

a. Revising paragraph (a);

b. Revising the introductory language of paragraph (b);

c. Revising paragraph (c);

d. Revising paragraph (d);

e. Revising the introductory language of paragraph (e);

f. Revising paragraph (f)(2); and

g. Adding new paragraphs (g) and (h).

The revisions are 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*. (1) The CEO of a banking entity described in paragraph (2) 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 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.

(2) The requirements of paragraph (c)(1) of this section apply to a banking entity if:

(i) The banking entity does not have limited trading assets and liabilities; or

(ii) The Board notifies the banking entity in writing that it must satisfy the requirements contained in paragraph (c)(1) of this section.

(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 with $50 billion or more in trading assets and liabilities (as calculated in accordance with the methodology described in the definition of "significant trading assets and liabilities" contained in § 248.2 of this part of this part) shall report the information required by the Appendix for each calendar month within 20 days of the end of each calendar month. Any other banking entity subject to the Appendix shall report the information required by the Appendix for each calendar quarter within 30 days of the end of that calendar quarter unless the Board notifies the banking entity in writing that it must report on a different basis.

(e) Additional documentation for covered funds. 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*. (i) 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.

(ii) Notice and Response Procedures.

(A) *Notice*. The Board will notify the banking entity in writing of any determination pursuant to paragraph (g)(2)(i) of this section to rebut the presumption described in this paragraph (g) and will provide an explanation of the determination.

(B) *Response*. (*1*) The banking entity may respond to any or all items in the notice described in paragraph (g)(2)(ii)(A) of this section. The response should include any matters that the banking entity would have the Board consider in deciding whether the banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. 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 promptly of the new time period, or with the consent of the banking entity. In its discretion, the Board may extend the time period for good cause.

(*2*) 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.

(C) After the close of banking entity's response period, the Board will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the Board's determination that banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

(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.

26. Remove Appendix A and Appendix B to Part 248 and add Appendix to Part 248 — Reporting and Recordkeeping Requirements for Covered Trading Activities to read as follows:

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:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 248.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 248.4; 248.5, or 248.6(a)-(b) (i.e., underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the Board of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. 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 the Board, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§248.2 and 248.3. In addition, for purposes of this appendix, the following definitions apply:

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(e), 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.. Risk and Position Limits and Usage;

ii. Risk Factor Sensitivities;

iii. Value-at-Risk and Stressed Value-at-Risk;

iv. Comprehensive Profit and Loss Attribution;

v. Positions;

vi. Transaction Volumes; and

vii. Securities Inventory Aging.

2. *Trading desk information*. Each banking entity made subject to this appendix by § __.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. *Quantitative measurements identifying information*. Each banking entity made subject to this appendix by § 248.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. *Narrative statement*. Each banking entity made subject to this appendix by § 248.20 must provide a separate 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;

iv. A list of the types of financial instruments and other products purchased and sold by the trading desk; an indication of which of these are the main financial instruments or products purchased and sold by the trading desk; and, for trading desks engaged in market making-related activities under § 248.4(b), specification of whether each type of financial instrument is included in market-maker positions or not included in market-maker positions. In addition, indicate whether the trading desk is including in its quantitative measurements products excluded from the definition of "financial instrument" under § 248.3(d)(2) and, if so, identify such products;

v. Identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and indication of which of the identified legal entities are the main booking entities for covered trading activities of the trading desk;

vi. For each legal entity that serves as a booking entity for covered trading activities, specification of any of the following applicable entity types for that legal entity:

A. National bank, Federal branch or Federal agency of a foreign bank, Federal savings association, Federal savings bank;

B. State nonmember bank, foreign bank having an insured branch, State savings association;

C. U.S.-registered broker-dealer, U.S.-registered security-based swap dealer, U.S.-registered major security-based swap participant;

D. Swap dealer, major swap participant, derivatives clearing organization, futures commission merchant, commodity pool operator, commodity trading advisor, introducing broker, floor trader, retail foreign exchange dealer;

E. State member bank;

F. Bank holding company, savings and loan holding company;

G. Foreign banking organization as defined in 12 CFR 211.21(o);

H. Uninsured State-licensed branch or agency of a foreign bank; or

I. Other entity type not listed above, including a subsidiary of a legal entity described above where the subsidiary itself is not an entity type listed above;

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*

1. Each banking entity must provide the following information regarding the quantitative measurements:

i. A Risk and Position Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit;

ii. A Risk Factor Sensitivities Information Schedule that provides identifying and descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement, including the name of the sensitivity, a unique identification label for the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit;

iii. 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;

iv. A Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule; and

v. A Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

d. ***Narrative Statement***

Each banking entity made subject to this appendix by § 248.20 must submit in a separate electronic document a Narrative Statement to the Board describing any changes in calculation methods used, a description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such change occurred. The Narrative

Statement must include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used.

If a banking entity does not have any information to report in a Narrative Statement, the banking entity must submit an electronic document stating that it does not have any information to report in a Narrative Statement.

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 Narrative Statement, the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the Board on the reporting schedule established in § __.20 unless otherwise requested by the Board. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the Board in accordance with the XML Schema specified and published on the Board's website.

f. *Recordkeeping*

A banking entity must, for any quantitative measurement furnished to the Board pursuant to this appendix and § 248.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the Board to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the Board.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in § 248.4 and § 248.5. A number of the metrics that are described below, including "Risk Factor Sensitivities" and "Value-at-Risk," relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market making activities under § 248.4(b) and hedging activity under § 248.5. Accordingly, the limits required under § 248.4(b)(2)(iii) and § 248.5(b)(1)(i)(A) must meet the applicable requirements under § 248.4(b)(2)(iii) and § 248.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, the "Risk Factor Sensitivities" and "Value-at-Risk" metrics except to the extent any of the "Risk Factor Sensitivities" or "Value-at-Risk" metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

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 Risk and Position 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. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk. A banking entity must report the risk factor sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. Reported risk factor sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings. A banking entity must provide the following information for each sensitivity that is reported pursuant to this quantitative measurement: the unique identification label for the risk factor sensitivity listed in the Risk Factor Sensitivities Information Schedule, the change in risk factor used to determine the risk factor sensitivity, and the aggregate change in value across all positions of the desk given the change in risk factor.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

3. Value-at-Risk and Stressed 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. For purposes of this appendix, Stressed Value-at-Risk ("Stressed 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 market conditions during a period of significant financial stress.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: For VaR, all trading desks engaged in covered trading activities. For Stressed VaR, all trading desks engaged in covered trading activities, except trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument" under § 248.3(d)(2).

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day.

The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. 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 that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

c. *Positions, Transaction Volumes, and Securities Inventory Aging 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."[421] A banking entity must separately report the trading desk's market value of long securities positions, market value of short securities positions, market value of derivatives receivables, market value of derivatives payables, notional value of derivatives receivables, and notional value of 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 four 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; (iii) trading desks and other organizational units where the transaction is booked in the same banking entity; and (iv) trading desks and other organizational units where the

[421] *See* §§ 248.2(i), (bb). 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.

transaction is booked into an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[422] 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.

3. Securities Inventory Aging

i. *Description:* For purposes of this appendix, Securities Inventory Aging generally describes a schedule of the market value of the trading desk's securities positions and the amount of time that those securities positions have been held. Securities Inventory Aging must measure the age profile of a trading desk's securities positions for the following 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. Securities Inventory Aging includes two schedules, a security asset-aging schedule, and a security liability-aging schedule. For purposes of the Securities Inventory

[422] *See* §§ 248.2(i), (bb).

Aging quantitative measurement, do not include securities that are also "derivatives," as those terms are defined under subpart A.[423]

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.

[423] *See* §§ 248.2(i), (bb).

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the Common Preamble, the Federal Deposit Insurance Corporation proposes to amend chapter III of Title 12, Code of Federal Regulations as follows:

PART 351 — PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

27. The authority citation for Part 351 continues to read as follows:

Authority: 12 U.S.C. 1851; 1811 et seq.; 3101 et seq.; and 5412.

28. Revise § 351.2 to read as follows:

§ 351.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the [Agency] determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(c) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(d) *Banking entity*. (1) Except as provided in paragraph (d)(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 (d)(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 (d)(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 (d)(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.

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *CFTC* means the Commodity Futures Trading Commission.

(g) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(h) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(i) *Derivative.* (1) Except as provided in paragraph (i)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(j) *Employee* includes a member of the immediate family of the employee.

(k) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(l) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(m) *FDIC* means the Federal Deposit Insurance Corporation.

(n) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(o) *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.

(p) *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.

(q) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(r) *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).

(s) *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 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)).

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

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1,000,000,000; and

(2) The FDIC has not determined pursuant to § 351.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(u) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(v) *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.

(w) *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)).

(x) *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.

(y) *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)).

(z) *SEC* means the Securities and Exchange Commission.

(aa) *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.

(bb) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(cc) *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)).

(dd) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(ee) *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.

(ff) *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 $10,000,000,000; or

(ii) The FDIC has determined pursuant to § 351.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (3), trading assets and liabilities for purposes of this paragraph (ff) means trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff) means the trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff)(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.

(gg) *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.

(hh) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ii) *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.

(jj) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

29. Amend § 351.3 by:

a. Revising paragraph (b);

b. Redesignating paragraphs (c) through (e) as paragraphs (d) through (f);

c. Adding a new paragraph (c);

d. Revising paragraph (e)(3);

e. Adding paragraph (e)(10);

f. Redesignating paragraphs (f)(5) through (f)(13) as paragraphs (f)(6) through (f)(14);

g. Adding a new paragraph (f)(5); and

h. Adding paragraph (g).

The revisions and additions read as follows:

§ 351.3. Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account*. *Trading account* means any account that is used by a banking entity to:

(1)(i) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(ii) With respect to 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, purchase or sell one or more financial instruments that are subject to 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, as amended from time to time.

(2) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(i) 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

(ii) 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; or

(3) Purchase or sell one or more financial instruments, with respect to a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards.

(c) *Presumption of compliance*. (1)(i) Each trading desk that does not purchase or sell financial instruments for a trading account defined in paragraphs (b)(1) or (b)(2) of this section may calculate the net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

(ii) If the sum of the absolute values of the daily net gain and loss figures determined in accordance with paragraph (c)(1)(i) of this section for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk shall be presumed to be in compliance with the prohibition in paragraph (a) of this section.

(2) The FDIC may rebut the presumption of compliance in paragraph (c)(1)(ii) of this section by providing written notice to the banking entity that the FDIC has determined that one or more of the banking entity's activities violates the prohibitions under subpart B.

(3) If a trading desk operating pursuant to paragraph (c)(1)(ii) of this section exceeds the $25 million threshold in that paragraph at any point, the banking entity shall, in accordance with any policies and procedures adopted by the FDIC:

(i) Promptly notify the FDIC;

(ii) Demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B; and

(iii) Demonstrate, with respect to the trading desk, how the banking entity will maintain compliance with subpart B on an ongoing basis.

* * * * *

(e) * * *

(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 physically-settled 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, with respect to such financial instruments:

(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 instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal

operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under §§ 351.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (e)(3) of this section; and

(vi) Is consistent with the FDIC's supervisory requirements, guidance, and expectations 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, and the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.

(f) * * *

(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.

* * * * *

(g) *Reservation of Authority*: (1)The FDIC may determine, on a case-by-case basis, that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account as defined at 12 U.S.C. 1851(h)(6).

(2) Notice and Response Procedures.

(i) Notice. When the FDIC determines that the purchase or sale of one or more financial instruments is for the trading account under paragraph (g)(1) of this section, the [Agency] will notify the banking entity in writing of the determination and provide an explanation of the determination.

(ii) Response.

(A) The banking entity may respond to any or all items in the notice. The response should include any matters that the banking entity would have the FDIC consider in deciding whether the purchase or sale is for the trading account. The response must be in writing and delivered to the designated FDIC official within 30 days after the date on which the banking entity received the notice. The FDIC may shorten the time period when, in the opinion of the FDIC, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the FDIC may extend the time period for good cause.

(B) Failure to respond within 30 days or such other time period as may be specified by the FDIC shall constitute a waiver of any objections to the FDIC's determination.

(iii) After the close of banking entity's response period, the FDIC will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the FDIC's determination that the purchase or sale of one or more financial instruments is for the trading account. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

30. Amend § 351.4 is amended by:

a. Revising paragraph (a)(2);

b. Adding paragraph (a)(8);

c. Revising paragraph (b)(2);

d. Revising the introductory text of paragraph (b)(3)(i);

e. In paragraph (b)(5) removing "*inventory*" wherever it appears and adding "*positions*" in its place; and

f. Adding paragraph (b)(6).

The revisions and additions read as follows:

§ 351.4. Permitted underwriting and market making-related activities.

(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 type of security, 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 type of security;

(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)(8)(i) of this section;

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

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

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

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

* * * * *

(8) *Rebuttable presumption of compliance*.

(i) *Risk limits*.

(A) A banking entity shall be presumed to meet the requirements of paragraph (a)(2)(ii)(A) 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 limits described in paragraph (a)(8)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (8)(i)(A) of this section shall be available with respect to limits for each trading desk 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.

(ii) *Supervisory review and oversight*. The limits described in paragraph (a)(8)(i) of this section shall be subject to supervisory review and oversight by the FDIC on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (a)(8)(i) of this section, a banking entity shall promptly report to the FDIC (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the FDIC.

(iv) *Rebutting the presumption*. The presumption in paragraph (a)(8)(i) of this section may be rebutted by the FDIC if the FDIC determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The FDIC will provide notice of any such determination to the banking entity in writing.

(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, based on the liquidity, maturity, and depth of the market for the relevant types of financial instrument(s).

(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)(6)(i) of this section;

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

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

(iv) In the case of a banking entity with significant trading assets and liabilities, to the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

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

(vi) The banking entity is licensed or registered to engage in activity described in paragraph (b) of this section in accordance with applicable law.

(3) * * *

(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 definition of "*significant trading assets and liabilities*" contained in § 351.2 of this part, unless:

* * * * *

(6) *Rebuttable presumption of compliance*. -- (i) *Risk limits*. (A) A banking entity shall be presumed to meet the requirements of paragraph (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 limits described in paragraph (b)(6)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (6)(i)(A) of this section shall be available with respect to limits for each trading desk 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, on the:

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

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

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

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

(ii) *Supervisory review and oversight*. The limits described in paragraph (b)(6)(i) of this section shall be subject to supervisory review and oversight by the FDIC on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (b)(6)(i) of this section, a banking entity shall promptly report to the FDIC (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s) , in each case in the form and manner as directed by the FDIC.

(iv) *Rebutting the presumption*. The presumption in paragraph (b)(6)(i) of this section may be rebutted by the FDIC if the FDIC determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The FDIC will provide notice of any such determination to the banking entity in writing.

31. Amend **§** 351.5 by revising paragraph (b), the introductory text of paragraph (c)(1), and adding paragraph (c)(4) to read as follows:

§ 351.5. 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 hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The hedging 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.

32. Amend **§** 351.6 by revising paragraph (e)(3), and removing paragraph (e)(6) to read as follows:

§ 351.6. Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

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

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

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

* * * * *

§ 351.10 [Amended].

33. Amend **§** 351.10 by:

a. In paragraph (c)(8)(i)(A) removing § 351.2(s)" and adding § 351.2(u)" in its place;

b. Removing paragraph (d)(1);

c. Redesignating paragraphs (d)(2) through (d)(10) as paragraphs (d)(1) through (d)(9);

d. In paragraph (d)(5)(i)(G) revising the reference to "(d)(6)(i)(A)" to read "(d)(5)(i)(A)"; and

e. In paragraph (d)(9) revising the reference to "(d)(9)" to read "(d)(8)" and the reference to "(d)(10)(i)(A)" to read "(d)(9)(i)(A)" and the reference to "(d)(10)(i)" to read "(d)(9)(i)".

34. Amend **§** 351. by revising paragraph (c) to read as follows:

§ 351.11. Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund*. The prohibition contained in § 351.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 351.4(a) or § 351.4(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 § 351.12(a)(2)(ii); § 351.12(a)(2)(iii), and § 351.12(d) of this subpart.

§ 351.12 [Amended].

35. Amend § 351.12 by:

a. In paragraphs (c)(1) and (d) removing "§ 351.10(d)(6)(ii)" to adding "§ 351.10(d)(5)(ii)" in its place;

b. Removing paragraph (e)(2)(vii); and

c. Redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

§ 351.13 [Amended].

36. Amend §351.13 by revising paragraphs (a) and (b)(3) and removing paragraph (b)(4)(iv) to read as follows:

§ 351.13. Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities*. (1) The prohibition contained in § 351.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) *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.

* * * * *

37. Section 351.14 is amended by revising paragraph (a)(2)(ii)(B) as follows:

§ 351.14. Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the FDIC (with a duty to update the certification if the information in the certification materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and

* * * * *

38. Section 351.20 is amended by:

a. Revising paragraph (a);

b. Revising the introductory language of paragraph (b);

c. Revising paragraph (c);

d. Revising paragraph (d);

e. Revising the introductory language of paragraph (e);

f. Revising paragraph (f)(2); and

g. Adding new paragraphs (g) and (h).

The revisions read as follows:

§ 351.20. Program for compliance; reporting.

(a) *Program requirement*. Each banking entity (other than a banking entity with limited trading assets and liabilities) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities*. With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation*.

(1) The CEO of a banking entity described in paragraph (2) must, based on a review by the CEO of the banking entity, attest in writing to the FDIC, each year no later than March 31, that the banking entity has in place processes 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.

(2) The requirements of paragraph (c)(1) apply to a banking entity if:

(i) The banking entity does not have limited trading assets and liabilities; or

(ii) The FDIC notifies the banking entity in writing that it must satisfy the requirements contained in paragraph (c)(1).

(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 FDIC notifies the banking entity in writing that it must satisfy the reporting requirements contained in the Appendix.

(2) Frequency of reporting: Unless the FDIC notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with the methodology described in the definition of "significant trading assets and liabilities" contained in § 351.2 of this part of this part) shall report the information required by the Appendix for each calendar month within 20 days of the end of each calendar month. Any other banking entity subject to the Appendix shall report the information required by the Appendix for each calendar quarter within 30 days of the end of that calendar quarter unless the FDIC notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds*. 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*.

(i) If upon examination or audit, the FDIC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C, the FDIC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities.

(ii) Notice and Response Procedures.

(A) Notice. The FDIC will notify the banking entity in writing of any determination pursuant to paragraph (g)(2)(i) of this section to rebut the presumption described in this paragraph (g) and will provide an explanation of the determination.

(B) Response.

(*1*) The banking entity may respond to any or all items in the notice described in paragraph (g)(2)(ii)(A) of this section. The response should include any matters that the banking entity

would have the FDIC consider in deciding whether the banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The response must be in writing and delivered to the designated FDIC official within 30 days after the date on which the banking entity received the notice. The FDIC may shorten the time period when, in the opinion of the FDIC, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the FDIC may extend the time period for good cause.

(*2*) Failure to respond within 30 days or such other time period as may be specified by the FDIC shall constitute a waiver of any objections to the FDIC's determination.

(C) After the close of banking entity's response period, the FDIC will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the FDIC's determination that banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

(h) *Reservation of authority*. Notwithstanding any other provision of this part, the FDIC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the FDIC determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C, 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.

39. Remove Appendix A and Appendix B to Part 351 and add Appendix to Part 351—Reporting and Recordkeeping Requirements for Covered Trading Activities to read as follows:

Appendix to Part 351—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B ("proprietary trading restrictions"). Pursuant to § 351.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the FDIC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 351.20.

b. The purpose of this appendix is to assist banking entities and the FDIC in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 351.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 351.4,351.5, or 351.6(a)-(b) (i.e., underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the FDIC of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is not intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 351.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk

tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 351.4 through 351.6(a)-(b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the FDIC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 351.2 and 351.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 351.4, 351.5, 351.6(a), or 351.6(b). A banking entity may include in its covered trading activity trading conducted under §§ 351.3(e), 351.6(c), 351.6(d), or 351.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. *Quantitative measurements*. Each banking entity made subject to this appendix by § 351.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Risk and Position Limits and Usage;

ii. Risk Factor Sensitivities;

iii. Value-at-Risk and Stressed Value-at-Risk;

iv. Comprehensive Profit and Loss Attribution;

v. Positions;

vi. Transaction Volumes; and

vii. Securities Inventory Aging.

2. *Trading desk information*. Each banking entity made subject to this appendix by § 351.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. *Quantitative measurements identifying information*. Each banking entity made subject to this appendix by § 351.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. *Narrative statement*. Each banking entity made subject to this appendix by § 351.20 must provide a separate narrative statement, as further described in this appendix.

5. *File identifying information*. Each banking entity made subject to this appendix by § 351.20 must provide file identifying information in each submission to the FDIC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. Trading Desk Information

Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

1. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;
2. Identification of each type of covered trading activity in which the trading desk is engaged;
3. Brief description of the general strategy of the trading desk;
4. A list of the types of financial instruments and other products purchased and sold by the trading desk; an indication of which of these are the main financial instruments or products purchased and sold by the trading desk; and, for trading desks engaged in market making-related activities under §351.4(b), specification of whether each type of financial instrument is included in market-maker positions or not included in market-

maker positions. In addition, indicate whether the trading desk is including in its quantitative measurements products excluded from the definition of "financial instrument" under § 351.3(d)(2) and, if so, identify such products;

5. Identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and indication of which of the identified legal entities are the main booking entities for covered trading activities of the trading desk;
6. For each legal entity that serves as a booking entity for covered trading activities, specification of any of the following applicable entity types for that legal entity:
    i. National bank, Federal branch or Federal agency of a foreign bank, Federal savings association, Federal savings bank;
    ii. State nonmember bank, foreign bank having an insured branch, State savings association;
    iii. U.S.-registered broker-dealer, U.S.-registered security-based swap dealer, U.S.-registered major security-based swap participant;
    iv. Swap dealer, major swap participant, derivatives clearing organization, futures commission merchant, commodity pool operator, commodity trading advisor, introducing broker, floor trader, retail foreign exchange dealer;
    v. State member bank;
    vi. Bank holding company, savings and loan holding company;
    vii. Foreign banking organization as defined in 12 CFR 211.21(o);
    viii. Uninsured State-licensed branch or agency of a foreign bank; or

ix. Other entity type not listed above, including a subsidiary of a legal entity described above where the subsidiary itself is not an entity type listed above;

7. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and
8. 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. A Risk and Position Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit;
2. A Risk Factor Sensitivities Information Schedule that provides identifying and descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement, including the name of the sensitivity, a unique identification label for the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit;
3. 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;

4. A Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule; and
5. A Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

d. Narrative Statement

Each banking entity made subject to this appendix by § 351.20 must submit in a separate electronic document a Narrative Statement to the FDIC describing any changes in calculation methods used, a description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement must include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used.

If a banking entity does not have any information to report in a Narrative Statement, the banking entity must submit an electronic document stating that it does not have any information to report in a Narrative Statement.

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 Narrative Statement, the Trading Desk Information, the

Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the FDIC on the reporting schedule established in § 351.20 unless otherwise requested by the FDIC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the FDIC in accordance with the XML Schema specified and published on the FDIC's website.

f. Recordkeeping

A banking entity must, for any quantitative measurement furnished to the FDIC pursuant to this appendix and § 351.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the FDIC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the FDIC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description*: For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in § 351.4 and § 351.5. A number of the metrics

that are described below, including "Risk Factor Sensitivities" and "Value-at-Risk," relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market making activities under § 351.4(b) and hedging activity under § 351.5. Accordingly, the limits required under § 351.4(b)(2)(iii) and § 351.5(b)(1)(i)(A) must meet the applicable requirements under § 351.4(b)(2)(iii) and § 351.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, the "Risk Factor Sensitivities" and "Value-at-Risk" metrics except to the extent any of the "Risk Factor Sensitivities" or "Value-at-Risk" metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

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 Risk and Position 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. Risk Factor Sensitivities

i. *Description*: For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk. A banking entity must report the risk factor sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. Reported risk factor sensitivities must

be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings. A banking entity must provide the following information for each sensitivity that is reported pursuant to this quantitative measurement: the unique identification label for the risk factor sensitivity listed in the Risk Factor Sensitivities Information Schedule, the change in risk factor used to determine the risk factor sensitivity, and the aggregate change in value across all positions of the desk given the change in risk factor.

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

3. Value-at-Risk and Stressed 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. For purposes of this appendix, Stressed Value-at-Risk ("Stressed 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 market conditions during a period of significant financial stress.

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: For VaR, all trading desks engaged in covered trading activities. For Stressed VaR, all trading desks engaged in covered trading activities, except trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument" under § __.3(d)(2).

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description*: For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day.

The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. 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 that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

c. Positions, Transaction Volumes, and Securities Inventory Aging 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, market value of short securities positions, market value

[1] *See* §§ 351.2(i), (bb). 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.

of derivatives receivables, market value of derivatives payables, notional value of derivatives receivables, and notional value of derivatives payables.

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks that rely on § 351.4(a) or § 351.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description*: For purposes of this appendix, Transaction Volumes measures four 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; (iii) trading desks and other organizational units where the transaction is booked in the same banking entity; and (iv) trading desks and other organizational units where the transaction is booked into an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[2] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 351.4(a) to conduct underwriting activity is a market participant identified in § 351.4(a)(7), and a customer of a trading desk that relies on § 351.4(b) to conduct market making-related activity is a market participant identified in § 351.4(b)(3).

[2] *See* §§ 351.2(i), (bb).

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks that rely on § 351.4(a) or § 351.4(b) to conduct underwriting activity or market-making-related activity, respectively.

3. Securities Inventory Aging

i. *Description*: For purposes of this appendix, Securities Inventory Aging generally describes a schedule of the market value of the trading desk's securities positions and the amount of time that those securities positions have been held. Securities Inventory Aging must measure the age profile of a trading desk's securities positions for the following 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. Securities Inventory Aging includes two schedules, a security asset-aging schedule, and a security liability-aging schedule. For purposes of the Securities Inventory Aging quantitative measurement, do not include securities that are also "derivatives," as those terms are defined under subpart A.[3]

ii. *Calculation Period*: One trading day.

iii. *Measurement Frequency*: Daily.

iv. *Applicability*: All trading desks that rely on § 351.4(a) or § 351.4(b) to conduct underwriting activity or market-making related activity, respectively.

[3] *See* §§ 351.2(i), (bb).

SECURITIES AND EXCHANGE COMMISSION

17 CFR Chapter II

Authority and Issuance

For the reasons set forth in the Common Preamble, the Securities and Exchange Commission proposes to amend Part 255 to chapter II of Title 17 of the Code of Federal Regulations as follows:

PART 255 PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

40. The authority for part 255 continues to read as follows:

Authority: 12 U.S.C. 1851

41. Revise § 255.2 to read as follows:

§ 255.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the SEC determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(c) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(d) *Banking entity.* (1) Except as provided in paragraph (d)(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 (d)(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 (d)(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 (d)(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.

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *CFTC* means the Commodity Futures Trading Commission.

(g) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(h) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(i) *Derivative.* (1) Except as provided in paragraph (i)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(j) *Employee* includes a member of the immediate family of the employee.

(k) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(l) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(m) *FDIC* means the Federal Deposit Insurance Corporation.

(n) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(o) *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.

(p) *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.

(q) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(r) *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).

(s) *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 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)).

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

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1,000,000,000; and

(2) The SEC has not determined pursuant to § 255.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(u) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(v) *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.

(w) *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)).

(x) *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.

(y) *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)).

(z) *SEC* means the Securities and Exchange Commission.

(aa) *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.

(bb) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(cc) *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)).

(dd) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(ee) *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.

(ff) *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 $10,000,000,000; or

(ii) The SEC has determined pursuant to § 255.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (3), trading assets and liabilities for purposes of this paragraph (ff) means trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff) means the trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff)(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.

(gg) *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.

(hh) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ii) *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.

(jj) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

42. Amend **§** 255.3 is amended by:

a. Revising paragraph (b);

b. Redesignating paragraphs (c) through (e) as paragraphs (d) through (f);

c. Adding a new paragraph (c);

d. Revising paragraph (e)(3);

e. Adding paragraph (e)(10);

f. Redesignating paragraphs (f)(5) through (f)(13) as paragraphs (f)(6) through (f)(14);

g. Adding a new paragraph (f)(5); and

h. Adding paragraph (g).

The revisions and additions read as follows:

§ 255.3 Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account*. *Trading account* means any account that is used by a banking entity to:

(1)(i) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(ii) With respect to 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, purchase or sell one or more financial instruments that are subject to 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, as amended from time to time.

(2) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(i) 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

(ii) 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; or

(3) Purchase or sell one or more financial instruments, with respect to a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards.

(c) *Presumption of compliance*. (1)(i) Each trading desk that does not purchase or sell financial instruments for a trading account defined in paragraphs (b)(1) or (b)(2) of this section may calculate the net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

(ii) If the sum of the absolute values of the daily net gain and loss figures determined in accordance with paragraph (c)(1)(i) of this section for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk shall be presumed to be in compliance with the prohibition in paragraph (a) of this section.

(2) The SEC may rebut the presumption of compliance in paragraph (c)(1)(ii) of this section by providing written notice to the banking entity that the SEC has determined that one or more of the banking entity's activities violates the prohibitions under subpart B.

(3) If a trading desk operating pursuant to paragraph (c)(1)(ii) of this section exceeds the $25 million threshold in that paragraph at any point, the banking entity shall, in accordance with any policies and procedures adopted by the SEC:

(i) Promptly notify the SEC;

(ii) Demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B; and

(iii) Demonstrate, with respect to the trading desk, how the banking entity will maintain compliance with subpart B on an ongoing basis.

* * * * *

(e) * * *

(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 physically-settled 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, with respect to such financial instruments:

(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 instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal

operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under §§ 255.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (e)(3) of this section; and

(vi) Is consistent with the SEC's supervisory requirements, guidance, and expectations 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, and the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.

(f) * * *

(5) *Cross-currency swa*p 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.

* * * * *

(g) *Reservation of Authority*: (1) The SEC may determine, on a case-by-case basis, that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account as defined at 12 U.S.C. 1851(h)(6).

(2) *Notice and Response Procedures*. (i) Notice. When the SEC determines that the purchase or sale of one or more financial instruments is for the trading account under paragraph (g)(1) of this section, the SEC will notify the banking entity in writing of the determination and provide an explanation of the determination.

(ii) *Response*. (A) The banking entity may respond to any or all items in the notice. The response should include any matters that the banking entity would have the SEC consider in deciding whether the purchase or sale is for the trading account. The response must be in writing and delivered to the designated SEC official within 30 days after the date on which the banking entity received the notice. The SEC may shorten the time period when, in the opinion of the SEC, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the SEC may extend the time period for good cause.

(B) Failure to respond within 30 days or such other time period as may be specified by the SEC shall constitute a waiver of any objections to the SEC's determination.

(iii) After the close of banking entity's response period, the SEC will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the SEC's determination that the purchase or sale of one or more financial instruments is for the trading account. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

43. Amend **§** 255.4 by:

a. Revising paragraph (a)(2);

b. Adding paragraph (a)(8);

c. Revising paragraph (b)(2);

d. Revising the introductory text of paragraph (b)(3)(i);

e. In paragraph (b)(5) removing the references to "*inventory*" and replacing them with "*positions*"; and

f. Adding paragraph (b)(6).

The revisions and additions read as follows:

§ 255.4 Permitted underwriting and market making-related activities.

(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 type of security, 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 type of security;

(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)(8)(i) of this section;

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

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

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

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

* * * * *

(8) *Rebuttable presumption of compliance.*

(i) *Risk limits.*

(A) A banking entity shall be presumed to meet the requirements of paragraph (a)(2)(ii)(A) 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 limits described in paragraph (a)(8)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (8)(i)(A) of this section shall be available with respect to limits for each trading desk 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.

(ii) *Supervisory review and oversight*. The limits described in paragraph (a)(8)(i) of this section shall be subject to supervisory review and oversight by the SEC on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (a)(8)(i) of this section, a banking entity shall promptly report to the SEC (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the SEC.

(iv) *Rebutting the presumption*. The presumption in paragraph (a)(8)(i) of this section may be rebutted by the SEC if the SEC determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The SEC will provide notice of any such determination to the banking entity in writing.

(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, based on the liquidity, maturity, and depth of the market for the relevant types of financial instrument(s).

(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)(6)(i) of this section;

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

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

(iv) In the case of a banking entity with significant trading assets and liabilities, to the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

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

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) * * *

(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 definition of "significant trading assets and liabilities" contained in § 255.2 of this part, unless:

* * * * *

(6) *Rebuttable presumption of compliance.*

(i) *Risk limits*.

(A) A banking entity shall be presumed to meet the requirements of paragraph (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 limits described in paragraph (b)(6)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (6)(i)(A) of this section shall be available with respect to limits for each trading desk 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, on the:

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

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

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

(*4*) Period of time a financial instrument may be held.

(ii) *Supervisory review and oversight*. The limits described in paragraph (b)(6)(i) of this section shall be subject to supervisory review and oversight by the SEC on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (b)(6)(i) of this section, a banking entity shall promptly report to the SEC (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the SEC.

(iv) *Rebutting the presumption*. The presumption in paragraph (b)(6)(i) of this section may be rebutted by the SEC if the SEC determines, based on all relevant facts and circumstances, that a trading desk is engaging in activity that is not based on the reasonably expected near term demands of clients, customers, or counterparties. The SEC will provide notice of any such determination to the banking entity in writing.

45. Amend **§** 255.5 by revising paragraph (b), the introductory text of paragraph (c)(1), and adding paragraph (c)(4) to read as follows:

§ 255.5 Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements*.

(1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C)Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * * (1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The hedging 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.

46. Amend §255.6 by revising paragraph (e)(3), and removing paragraph (e)(6) to read as follows:

§ 255.6 Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

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

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

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

* * * * *

§ 255.10 [Amended].

47. Amend **§** 255.10 by:

a. In paragraph (c)(8)(i)(A) revising the reference to "§ 255.2(s)" to read "§ 255.2(u)";

b. Removing paragraph (d)(1);

c. Redesignating paragraphs (d)(2) through (d)(10) as paragraphs (d)(1) through (d)(9);

d. In paragraph (d)(5)(i)(G) revising the reference to "(d)(6)(i)(A)" to read "(d)(5)(i)(A)"; and

e. In paragraph (d)(9) revising the reference to "(d)(9)" to read "(d)(8)" and the reference to "(d)(10)(i)(A)" to read "(d)(9)(i)(A)" and the reference to "(d)(10)(i)" to read "(d)(9)(i)".

48. Amend **§** 255.11 by revising paragraph (c) to read as follows:

§ 255.11 Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 255.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 255.4(a) or § 255.4(b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*-11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78*o*-11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 255.12(a)(2)(ii); § 255.12(a)(2)(iii), and § 255.12(d) of this subpart.4

§ 255.12[Amended].

49. Amend § 255.12 by:

a. In paragraphs (c)(1) and (d) revising the references to "§ 255.10(d)(6)(ii)" to read "§ 255.10(d)(5)(ii)";

b. Removing paragraph (e)(2)(vii); and

c. Redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

50. Amend § 255.13 by revising paragraphs (a) and (b)(3), and removing paragraph (b)(4)(iv) to read as follows:

§ 255.13 Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 255.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) *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.

* * * * *

51. Amend **§** 255.14 by revising paragraph (a)(2)(ii)(B) as follows:

§ 255.14 Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the SEC (with a duty to update the certification if the information in the certification materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and

* * * * *

52. Amend **§** 255.20 by:

a. Revising paragraphs (a), (c), (d), and (f)(2)

b. Revising the introductory text of paragraphs (b) and (e);

c. Adding new paragraphs (g) and (h).

The revisions read as follows:

§ 255.20 Program for compliance; reporting.

* * * * *

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities*. With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation*.

(1) The CEO of a banking entity described in paragraph (2) must, based on a review by the CEO of the banking entity, attest in writing to the SEC, each year no later than March 31, that the banking entity has in place processes 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.

(2) The requirements of paragraph (c)(1) apply to a banking entity if:

(i) The banking entity does not have limited trading assets and liabilities; or

(ii) The SEC notifies the banking entity in writing that it must satisfy the requirements contained in paragraph (c)(1).

(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 SEC notifies the banking entity in writing that it must satisfy the reporting requirements contained in the Appendix.

(2) Frequency of reporting: Unless the SEC notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with the methodology described in the definition of "significant trading assets and liabilities" contained in § 255.2 of this part of this part) shall report the information required by the Appendix for each calendar month within 20 days of the end of each calendar month. Any other banking entity subject to the Appendix shall report the information required by the Appendix for each calendar quarter within 30 days of the end of that calendar quarter unless the SEC notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* 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*.

(i) If upon examination or audit, the SEC determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C, the SEC may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities.

(ii) Notice and Response Procedures.

(A) Notice. The SEC will notify the banking entity in writing of any determination pursuant to paragraph (g)(2)(i) of this section to rebut the presumption described in this paragraph (g) and will provide an explanation of the determination.

(B) Response.

(I) The banking entity may respond to any or all items in the notice described in paragraph (g)(2)(ii)(A) of this section. The response should include any matters that the banking entity would have the SEC consider in deciding whether the banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The response must be in writing and delivered to the designated SEC official within 30 days after the date on which the banking entity received the notice. The SEC may shorten the time period when, in the opinion of the SEC, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the SEC may extend the time period for good cause.

(II) Failure to respond within 30 days or such other time period as may be specified by the SEC shall constitute a waiver of any objections to the SEC's determination.

(C) After the close of banking entity's response period, the SEC will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the SEC's determination that banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the SEC retains its authority to require a banking entity without significant trading assets and liabilities to apply any requirements of this part that would otherwise apply if the banking entity had significant or moderate trading assets and liabilities if the SEC determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion of subpart B or subpart C, 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.

53. Remove Appendix A and Appendix B to part 255 and add Appendix to Part 255—Reporting and Recordkeeping Requirements for Covered Trading Activities to read as follows:

Appendix to Part 255—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B ("proprietary trading restrictions"). Pursuant to § 255.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the SEC regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 255.20.

b. The purpose of this appendix is to assist banking entities and the SEC in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 255.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 255.4, 255.5, or 255.6(a)-(b) (i.e., underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the SEC of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 255.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk

tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 255.4 through 255.6(a)-(b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the SEC, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 255.2 and 255.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 255.4, 255.5, 255.6(a), or 255.6(b). A banking entity may include in its covered trading activity trading conducted under §§ 255.3(e), 255.6(c), 255.6(d), or 255.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. *Quantitative measurements*. Each banking entity made subject to this appendix by § 255.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Risk and Position Limits and Usage;

ii. Risk Factor Sensitivities;

iii. Value-at-Risk and Stressed Value-at-Risk;

iv. Comprehensive Profit and Loss Attribution;

v. Positions;

vi. Transaction Volumes; and

vii. Securities Inventory Aging.

2. *Trading desk information*. Each banking entity made subject to this appendix by § 255.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. *Quantitative measurements identifying information*. Each banking entity made subject to this appendix by § 255.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. *Narrative statement*. Each banking entity made subject to this appendix by § 255.20 must provide a separate narrative statement, as further described in this appendix.

5. *File identifying information*. Each banking entity made subject to this appendix by § 255.20 must provide file identifying information in each submission to the SEC pursuant to this appendix, including the name of the banking entity, the RSSD ID assigned to the top-tier banking entity by the Board, and identification of the reporting period and creation date and time.

b. *Trading Desk Information*

Each banking entity must provide descriptive information regarding each trading desk engaged in covered trading activities, including:

1. Name of the trading desk used internally by the banking entity and a unique identification label for the trading desk;
2. Identification of each type of covered trading activity in which the trading desk is engaged;
3. Brief description of the general strategy of the trading desk;
4. A list of the types of financial instruments and other products purchased and sold by the trading desk; an indication of which of these are the main financial instruments or products purchased and sold by the trading desk; and, for trading desks engaged in market making-related activities under § 255.4(b), specification of whether each type of financial instrument is included in market-maker positions or not included in market-

maker positions. In addition, indicate whether the trading desk is including in its quantitative measurements products excluded from the definition of "financial instrument" under § 255.3(d)(2) and, if so, identify such products;

5. Identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and indication of which of the identified legal entities are the main booking entities for covered trading activities of the trading desk;
6. For each legal entity that serves as a booking entity for covered trading activities, specification of any of the following applicable entity types for that legal entity:
   i. National bank, Federal branch or Federal agency of a foreign bank, Federal savings association, Federal savings bank;
   ii. State nonmember bank, foreign bank having an insured branch, State savings association;
   iii. U.S.-registered broker-dealer, U.S.-registered security-based swap dealer, U.S.-registered major security-based swap participant;
   iv, Swap dealer, major swap participant, derivatives clearing organization, futures commission merchant, commodity pool operator, commodity trading advisor, introducing broker, floor trader, retail foreign exchange dealer;
   v. State member bank;
   vi. Bank holding company, savings and loan holding company;
   vii. Foreign banking organization as defined in 12 CFR 211.21(o);
   viii. Uninsured State-licensed branch or agency of a foreign bank; or

ix. Other entity type not listed above, including a subsidiary of a legal entity described above where the subsidiary itself is not an entity type listed above;

7. Indication of whether each calendar date is a trading day or not a trading day for the trading desk; and
8. 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. A Risk and Position Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit;
2. A Risk Factor Sensitivities Information Schedule that provides identifying and descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement, including the name of the sensitivity, a unique identification label for the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit;
3. 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;

4. A Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule; and
5. A Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

d. ***Narrative Statement***

Each banking entity made subject to this appendix by § 255.20 must submit in a separate electronic document a Narrative Statement to the SEC describing any changes in calculation methods used, a description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement must include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used.

If a banking entity does not have any information to report in a Narrative Statement, the banking entity must submit an electronic document stating that it does not have any information to report in a Narrative Statement.

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 Narrative Statement, the Trading Desk Information, the

Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the SEC on the reporting schedule established in § 255.20 unless otherwise requested by the SEC. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the SEC in accordance with the XML Schema specified and published on the SEC's website.

f. *Recordkeeping*

A banking entity must, for any quantitative measurement furnished to the SEC pursuant to this appendix and § 255.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the SEC to verify the accuracy of such reports, for a period of five years from the end of the calendar year for which the measurement was taken. A banking entity must retain the Narrative Statement, the Trading Desk Information, and the Quantitative Measurements Identifying Information for a period of five years from the end of the calendar year for which the information was reported to the SEC.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and include, but are not limited to, the limits set out in § 255.4 and § 255.5. A number of the metrics

that are described below, including "Risk Factor Sensitivities" and "Value-at-Risk," relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market making activities under § 255.4(b) and hedging activity under § 255.5. Accordingly, the limits required under § 255.4(b)(2)(iii) and § 255.5(b)(1)(i)(A) must meet the applicable requirements under § 255.4(b)(2)(iii) and § 255.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, the "Risk Factor Sensitivities" and "Value-at-Risk" metrics except to the extent any of the "Risk Factor Sensitivities" or "Value-at-Risk" metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

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 Risk and Position 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. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk. A banking entity must report the risk factor sensitivities that are monitored and managed as part of the trading desk's overall risk management policy. Reported risk factor sensitivities must

be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings. A banking entity must provide the following information for each sensitivity that is reported pursuant to this quantitative measurement: the unique identification label for the risk factor sensitivity listed in the Risk Factor Sensitivities Information Schedule, the change in risk factor used to determine the risk factor sensitivity, and the aggregate change in value across all positions of the desk given the change in risk factor.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

3. Value-at-Risk and Stressed 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. For purposes of this appendix, Stressed Value-at-Risk ("Stressed 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 market conditions during a period of significant financial stress.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: For VaR, all trading desks engaged in covered trading activities. For Stressed VaR, all trading desks engaged in covered trading activities, except trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument" under § 255.3(d)(2).

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day.

The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. 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 that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

c. *Positions, Transaction Volumes, and Securities Inventory Aging 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, market value of short securities positions, market value

[1] *See* §§ 255.2(i), (bb). 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.

of derivatives receivables, market value of derivatives payables, notional value of derivatives receivables, and notional value of derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 255.4(a) or § 255.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description*: For purposes of this appendix, Transaction Volumes measures four 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; (iii) trading desks and other organizational units where the transaction is booked in the same banking entity; and (iv) trading desks and other organizational units where the transaction is booked into an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[2] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a trading desk that relies on § 255.4(a) to conduct underwriting activity is a market participant identified in § 255.4(a)(7), and a customer of a trading desk that relies on § 255.4(b) to conduct market making-related activity is a market participant identified in § 255.4(b)(3).

[2] *See* §§ 255.2(i), (bb).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 255.4(a) or § 255.4(b) to conduct underwriting activity or market-making-related activity, respectively.

3. Securities Inventory Aging

i. *Description:* For purposes of this appendix, Securities Inventory Aging generally describes a schedule of the market value of the trading desk's securities positions and the amount of time that those securities positions have been held. Securities Inventory Aging must measure the age profile of a trading desk's securities positions for the following 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. Securities Inventory Aging includes two schedules, a security asset-aging schedule, and a security liability-aging schedule. For purposes of the Securities Inventory Aging quantitative measurement, do not include securities that are also "derivatives," as those terms are defined under subpart A.[3]

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 255.4(a) or § 255.4(b) to conduct underwriting activity or market-making related activity, respectively

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[3] *See* §§ 255.2(i), (bb).

COMMODITY FUTURES TRADING COMMISSION

17 CFR Chapter I

Authority and Issuance

For the reasons set forth in the Common Preamble, the Commodity Futures Trading Commission proposes to amend Part 75 to chapter I of Title 17 of the Code of Federal Regulations as follows:

54. The authority for part 75 continues to read as follows:

Authority: 12 U.S.C. 1851.

PART 75 — PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

55. Revise § 75.2 to read as follows:

§ 75.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) *Affiliate* has the same meaning as in section 2(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(k)).

(b) *Applicable accounting standards* means U.S. generally accepted accounting principles, or such other accounting standards applicable to a banking entity that the Commission determines are appropriate and that the banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(c) *Bank holding company* has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

(d) *Banking entity.* (1) Except as provided in paragraph (d)(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 (d)(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 (d)(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 (d)(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.

(e) *Board* means the Board of Governors of the Federal Reserve System.

(f) *CFTC* means the Commodity Futures Trading Commission.

(g) *Dealer* has the same meaning as in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5)).

(h) *Depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(i) *Derivative.* (1) Except as provided in paragraph (i)(2) of this section, *derivative* means:

(i) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(ii) Any purchase or sale of a commodity, that is not an excluded commodity, for deferred shipment or delivery that is intended to be physically settled;

(iii) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(iv) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(v) Any agreement, contract, or transaction in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(vi) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(2) A derivative does not include:

(i) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)); or

(ii) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(j) *Employee* includes a member of the immediate family of the employee.

(k) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(l) *Excluded commodity* has the same meaning as in section 1a(19) of the Commodity Exchange Act (7 U.S.C. 1a(19)).

(m) *FDIC* means the Federal Deposit Insurance Corporation.

(n) *Federal banking agencies* means the Board, the Office of the Comptroller of the Currency, and the FDIC.

(o) *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.

(p) *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.

(q) *General account* means all of the assets of an insurance company except those allocated to one or more separate accounts.

(r) *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).

(s) *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 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)).

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

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than $1,000,000,000; and

(2) The Commission has not determined pursuant to § 75.20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.

(u) *Loan* means any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.

(v) *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.

(w) *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)).

(x) *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.

(y) *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)).

(z) *SEC* means the Securities and Exchange Commission.

(aa) *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.

(bb) *Security* has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(cc) *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)).

(dd) *Security future* has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(ee) *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.

(ff) *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 $10,000,000,000; or

(ii) The Commission has determined pursuant to § 75.20(h) of this part that the banking entity should be treated as having significant trading assets and liabilities.

(2) With respect to a banking entity other than a banking entity described in paragraph (3), trading assets and liabilities for purposes of this paragraph (ff) means trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff) means the trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) 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 (ff)(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.

(gg) *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.

(hh) *Subsidiary* has the same meaning as in section 2(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(d)).

(ii) *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.

(jj) *Swap dealer* has the same meaning as in section 1(a)(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)).

56. Amend § 75.3 by:

a. Revising paragraph (b);

b. Redesignating paragraphs (c) through (e) as paragraphs (d) through (f);

c. Adding a new paragraph (c);

d. Revising paragraph (e)(3);

e. Adding paragraph (e)(10);

f. Redesignating paragraphs (f)(5) through (f)(13) as paragraphs (f)(6) through (f)(14);

g. Adding a new paragraph (f)(5); and

h. Adding paragraph (g).

The revisions and additions read as follows:

§ 75.3. Prohibition on proprietary trading.

* * * * *

(b) *Definition of trading account*. *Trading account* means any account that is used by a banking entity to:

(1)(i) Purchase or sell one or more financial instruments that are both market risk capital rule covered positions and trading positions (or hedges of other market risk capital rule covered positions), if the banking entity, or any affiliate of the banking entity, is an insured depository institution, bank holding company, or savings and loan holding company, and calculates risk-based capital ratios under the market risk capital rule; or

(ii) With respect to 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, purchase or sell one or more financial instruments that are subject to 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, as amended from time to time.

(2) Purchase or sell one or more financial instruments for any purpose, if the banking entity:

(i) 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

(ii) 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; or

(3) Purchase or sell one or more financial instruments, with respect to a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards.

(c) *Presumption of compliance*. (1)(i) Each trading desk that does not purchase or sell financial instruments for a trading account defined in paragraphs (b)(1) or (b)(2) of this section may calculate the net gain or net loss on the trading desk's portfolio of financial instruments each business day, reflecting realized and unrealized gains and losses since the previous business day, based on the banking entity's fair value for such financial instruments.

(ii) If the sum of the absolute values of the daily net gain and loss figures determined in accordance with paragraph (c)(1)(i) of this section for the preceding 90-calendar-day period does not exceed $25 million, the activities of the trading desk shall be presumed to be in compliance with the prohibition in paragraph (a) of this section.

(2) The Commission may rebut the presumption of compliance in paragraph (c)(1)(ii) of this section by providing written notice to the banking entity that the Commission has determined that one or more of the banking entity's activities violates the prohibitions under subpart B.

(3) If a trading desk operating pursuant to paragraph (c)(1)(ii) of this section exceeds the $25 million threshold in that paragraph at any point, the banking entity shall, in accordance with any policies and procedures adopted by the Commission:

(i) Promptly notify the Commission;

(ii) Demonstrate that the trading desk's purchases and sales of financial instruments comply with subpart B; and

(iii) Demonstrate, with respect to the trading desk, how the banking entity will maintain compliance with subpart B on an ongoing basis.

* * * * *

(e) * * *

(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 physically-settled 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, with respect to such financial instruments:

(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 instruments purchased or sold for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal

operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan;

(v) Includes written policies and procedures, internal controls, analysis, and independent testing to ensure that the purchase and sale of financial instruments that are not permitted under §§ 75.6(a) or (b) of this subpart are for the purpose of liquidity management and in accordance with the liquidity management plan described in paragraph (e)(3) of this section; and

(vi) Is consistent with the Commission's supervisory requirements, guidance, and expectations 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, and the erroneously purchased (or sold) financial instrument is promptly transferred to a separately-managed trade error account for disposition.

(f) * * *

(5) *Cross-currency swa*p 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.

* * * * *

(g) *Reservation of Authority*: (1)The Commission may determine, on a case-by-case basis, that a purchase or sale of one or more financial instruments by a banking entity either is or is not for the trading account as defined at 12 U.S.C. 1851(h)(6).

(2) *Notice and Response Procedures*.-- (i) *Notice*. When the Commission determines that the purchase or sale of one or more financial instruments is for the trading account under paragraph (g)(1) of this section, the Commission will notify the banking entity in writing of the determination and provide an explanation of the determination.

(ii) *Response*. (A) The banking entity may respond to any or all items in the notice. The response should include any matters that the banking entity would have the Commission consider in deciding whether the purchase or sale is for the trading account. The response must be in writing and delivered to the designated Commission official within 30 days after the date on which the banking entity received the notice. The Commission may shorten the time period when, in the opinion of the Commission, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the Commission may extend the time period for good cause.

(B) Failure to respond within 30 days or such other time period as may be specified by the Commission shall constitute a waiver of any objections to the Commission's determination.

(iii) After the close of banking entity's response period, the Commission will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the Commission's determination that the purchase or sale of one or more financial instruments is for the trading account. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

57. Amend § 75.4 by:

a. Revising paragraph (a)(2);

b. Adding paragraph (a)(8);

c. Revising paragraph (b)(2);

d. Revising the introductory text of paragraph (b)(3)(i);

e. In paragraph (b)(5) revising the references to "*inventory*" to read "*positions*"; and

f. Adding paragraph (b)(6).

The revisions and additions to read as follows:

§ 75.4. Permitted underwriting and market making-related activities.

(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 type of security, 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 type of security;

(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)(8)(i) of this section;

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

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

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

(v) The banking entity is licensed or registered to engage in the activity described in this paragraph (a) in accordance with applicable law.

* * * * *

(8) *Rebuttable presumption of compliance.*

(i) *Risk limits.*

(A) A banking entity shall be presumed to meet the requirements of paragraph (a)(2)(ii)(A) 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 limits described in paragraph (a)(8)(i)(B) and does not exceed such limits.

(B) The presumption described in paragraph (8)(i)(A) of this section shall be available with respect to limits for each trading desk 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.

(ii) *Supervisory review and oversight*. The limits described in paragraph (a)(8)(i) of this section shall be subject to supervisory review and oversight by the Commission on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (a)(8)(i) of this section, a banking entity shall promptly report to the Commission (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s), in each case in the form and manner as directed by the Commission.

(iv) *Rebutting the presumption*. The presumption in paragraph (a)(8)(i) of this section may be rebutted by the Commission if the Commission determines, 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 Commission will provide notice of any such determination to the banking entity in writing.

(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, based on the liquidity, maturity, and depth of the market for the relevant types of financial instrument(s).

(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)(6)(i) of this section;

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

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

(iv) In the case of a banking entity with significant trading assets and liabilities, to the extent that any limit identified pursuant to paragraph (b)(2)(iii)(C) of this section is exceeded, the trading desk takes action to bring the trading desk into compliance with the limits as promptly as possible after the limit is exceeded;

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

(vi) The banking entity is licensed or registered to engage in activity described in this paragraph (b) in accordance with applicable law.

(3) * * *

(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 definition of "significant trading assets and liabilities" contained in § 75.2 of this part, unless:

* * * * *

(6) *Rebuttable presumption of compliance*. -- (i) *Risk limits*. (A) A banking entity shall be presumed to meet the requirements of paragraph (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 limits described in paragraph (b)(6)(i)(B) of this section and does not exceed such limits.

(B) The presumption described in paragraph (6)(i)(A) of this section shall be available with respect to limits for each trading desk 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, on the:

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

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

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

(*4*) Period of time a financial instrument may be held.

(ii) *Supervisory review and oversight.* The limits described in paragraph (b)(6)(i) of this section shall be subject to supervisory review and oversight by the Commission on an ongoing basis. 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.

(iii) *Reporting*. With respect to any limit identified pursuant to paragraph (b)(6)(i) of this section, a banking entity shall promptly report to the Commission (A) to the extent that any limit is exceeded and (B) any temporary or permanent increase to any limit(s) , in each case in the form and manner as directed by the Commission.

(iv) *Rebutting the presumption*. The presumption in paragraph (b)(6)(i) of this section may be rebutted by the Commission if the Commission determines, 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 Commission will provide notice of any such determination to the banking entity in writing.

■ 58. Amend § 75.5 by revising paragraph (b), the introductory text of paragraph (c)(1), and adding paragraph (c)(4) to read as follows:

§ 75.5. Permitted risk-mitigating hedging activities.

* * * * *

(b) *Requirements*. (1) The risk-mitigating hedging activities of a banking entity that has significant trading assets and liabilities are permitted under paragraph (a) of this section only if:

(i) The banking entity has established and implements, maintains and enforces an internal compliance program required by subpart D of this part that is reasonably designed to ensure the banking entity's compliance with the requirements of this section, including:

(A) Reasonably designed written policies and procedures regarding the positions, techniques and strategies that may be used for hedging, including documentation indicating what positions, contracts or other holdings a particular trading desk may use in its risk-mitigating hedging activities, as well as position and aging limits with respect to such positions, contracts or other holdings;

(B) Internal controls and ongoing monitoring, management, and authorization procedures, including relevant escalation procedures; and

(C) The conduct of analysis and independent testing designed to ensure that the positions, techniques and strategies that may be used for hedging may reasonably be expected to reduce or otherwise significantly mitigate the specific, identifiable risk(s) being hedged;

(ii) The risk-mitigating hedging activity:

(A) Is conducted in accordance with the written policies, procedures, and internal controls required under this section;

(B) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof;

(C)Does not give rise, at the inception of the hedge, to any significant new or additional risk that is not itself hedged contemporaneously in accordance with this section;

(D) Is subject to continuing review, monitoring and management by the banking entity that:

(*1*) Is consistent with the written hedging policies and procedures required under paragraph (b)(1)(i) of this section;

(*2*) Is designed to reduce or otherwise significantly mitigate the specific, identifiable risks that develop over time from the risk-mitigating hedging activities undertaken under this section and the underlying positions, contracts, and other holdings of the banking entity, based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof; and

(*3*) Requires ongoing recalibration of the hedging activity by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(1)(ii) of this section and is not prohibited proprietary trading; and

(iii) The compensation arrangements of persons performing risk-mitigating hedging activities are designed not to reward or incentivize prohibited proprietary trading.

(2) The risk-mitigating hedging activities of a banking entity that does not have significant trading assets and liabilities are permitted under paragraph (a) of this section only if the risk-mitigating hedging activity:

(i) At the inception of the hedging activity, including, without limitation, any adjustments to the hedging activity, is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, commodity price risk, basis risk, or similar risks, arising in connection with and related to identified positions, contracts, or other holdings of the banking entity, based upon the facts and circumstances of the identified underlying and hedging positions, contracts or other holdings and the risks and liquidity thereof; and

(ii) Is subject, as appropriate, to ongoing recalibration by the banking entity to ensure that the hedging activity satisfies the requirements set out in paragraph (b)(2) of this section and is not prohibited proprietary trading.

(c) * * * (1) A banking entity that has significant trading assets and liabilities must comply with the requirements of paragraphs (c)(2) and (3) of this section, unless the requirements of paragraph (c)(4) of this section are met, with respect to any purchase or sale of financial instruments made in reliance on this section for risk-mitigating hedging purposes that is:

* * * * *

(4) The requirements of paragraphs (c)(2) and (3) of this section do not apply to the purchase or sale of a financial instrument described in paragraph (c)(1) of this section if:

(i) The financial instrument purchased or sold is identified on a written list of pre-approved financial instruments that are commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold; and

(ii) At the time the financial instrument is purchased or sold, the hedging activity (including the purchase or sale of the financial instrument) complies with written, pre-approved hedging limits for the trading desk purchasing or selling the financial instrument for hedging activities undertaken for one or more other trading desks. The hedging 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.

59. Amend § 75.6 by revising paragraph (e)(3) and removing paragraph (e)(6) to read as follows:

§ 75.6. Other permitted proprietary trading activities.

* * * * *

(e) * * *

(3) A purchase or sale by a banking entity is permitted for purposes of this paragraph (e) if:

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

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

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

* * * * *

§ 75.10 [Amended].

60. Amend § 75.10 by:

a. In paragraph (c)(8)(i)(A) revising the reference to "§ 75.2(s)" to read "§ 75.2(u)";

b. Removing paragraph (d)(1);

c. Redesignating paragraphs (d)(2) through (d)(10) as paragraphs (d)(1) through (d)(9);

d. In paragraph (d)(5)(i)(G) revising the reference to "(d)(6)(i)(A)" to read "(d)(5)(i)(A)"; and

e. In paragraph (d)(9) revising the reference to "(d)(9)" to read "(d)(8)" and the reference to "(d)(10)(i)(A)" to read "(d)(9)(i)(A)" and the reference to "(d)(10)(i)" to read "(d)(9)(i)".

61. Amend § 75.11 by revising paragraph (c) to read as follows:

§ 75.11. Permitted organizing and offering, underwriting, and market making with respect to a covered fund.

* * * * *

(c) *Underwriting and market making in ownership interests of a covered fund.* The prohibition contained in § 75.10(a) of this subpart does not apply to a banking entity's underwriting activities or market making-related activities involving a covered fund so long as:

(1) Those activities are conducted in accordance with the requirements of § 75.4(a) or § 75.4(b) of subpart B, respectively; and

(2) With respect to any banking entity (or any affiliate thereof) that: Acts as a sponsor, investment adviser or commodity trading advisor to a particular covered fund or otherwise acquires and retains an ownership interest in such covered fund in reliance on paragraph (a) of this section; or acquires and retains an ownership interest in such covered fund and is either a securitizer, as that term is used in section 15G(a)(3) of the Exchange Act (15 U.S.C. 78*o*-11(a)(3)), or is acquiring and retaining an ownership interest in such covered fund in compliance with section 15G of that Act (15 U.S.C.78*o*-11) and the implementing regulations issued thereunder each as permitted by paragraph (b) of this section, then in each such case any ownership interests acquired or retained by the banking entity and its affiliates in connection with underwriting and market making related activities for that particular covered fund are included in the calculation of ownership interests permitted to be held by the banking entity and its affiliates under the limitations of § 75.12(a)(2)(ii); § 75.12(a)(2)(iii), and § 75.12(d) of this subpart.

§75.12 [Amended].

62. In subpart C, section 75.12 is amended by:

a. In paragraphs (c)(1) and (d) revising the references to "§ 75.10(d)(6)(ii)" to read "§ 75.10(d)(5)(ii)";

b. Removing paragraph (e)(2)(vii); and

c. Redesignating the second instance of paragraph (e)(2)(vi) as paragraph (e)(2)(vii).

63. Amend § 75.13 by revising paragraphs (a) and (b)(3) and removing (b)(4)(iv) to read as follows:

§ 75.13. Other permitted covered fund activities and investments.

(a) *Permitted risk-mitigating hedging activities.* (1) The prohibition contained in § 75.10(a) of this subpart does not apply with respect to an ownership interest in a covered fund acquired or retained by a banking entity that is designed to reduce or otherwise significantly mitigate the specific, identifiable risks to the banking entity in connection with:

(i) A compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund; or

(ii) A position taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.

(2) *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.

* * * * *

64. Amend § 75.14 by revising paragraph (a)(2)(ii)(B) as follows:

§ 75.14. Limitations on relationships with a covered fund.

(a) * * *

(2) * * *

(ii) * * *

(B) The chief executive officer (or equivalent officer) of the banking entity certifies in writing annually no later than March 31 to the Commission (with a duty to update the certification if the information in the certification materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and

* * * * *

65. Amend § 75.20 by:

a. Revising paragraphs (a), (c), (d), and (f)(2);

b. Revising the introductory text of paragraphs (b) and (e)

c. Adding paragraphs (g) and (h).

The revisions amd additions to read as follows:

§ 75.20. Program for compliance; reporting.

(a) *Program requirement.* Each banking entity (other than a banking entity with limited trading assets and liabilities) shall develop and provide for the continued administration of a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part. The terms, scope, and detail of the compliance program shall be appropriate for the types, size, scope, and complexity of activities and business structure of the banking entity.

(b) *Banking entities with significant trading assets and liabilities*. With respect to a banking entity with significant trading assets and liabilities, the compliance program required by paragraph (a) of this section, at a minimum, shall include:

* * * * *

(c) *CEO attestation*.

(1) The CEO of a banking entity described in paragraph (2) must, based on a review by the CEO of the banking entity, attest in writing to the Commission, each year no later than March 31, that the banking entity has in place processes 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.

(2) The requirements of paragraph (c)(1) apply to a banking entity if:

(i) The banking entity does not have limited trading assets and liabilities; or

(ii) The Commission notifies the banking entity in writing that it must satisfy the requirements contained in paragraph (c)(1).

(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 Commission notifies the banking entity in writing that it must satisfy the reporting requirements contained in the Appendix.

(2) Frequency of reporting: Unless the Commission notifies the banking entity in writing that it must report on a different basis, a banking entity with $50 billion or more in trading assets and liabilities (as calculated in accordance with the methodology described in the definition of "significant trading assets and liabilities" contained in § 75.2 of this part of this part) shall report the information required by the Appendix for each calendar month within 20 days of the end of each calendar month. Any other banking entity subject to the Appendix shall report the information required by the Appendix for each calendar quarter within 30 days of the end of that calendar quarter unless the Commission notifies the banking entity in writing that it must report on a different basis.

(e) *Additional documentation for covered funds.* 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*.

(i) If upon examination or audit, the Commission 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 Commission may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities.

(ii) Notice and Response Procedures.

(A) Notice. The Commission will notify the banking entity in writing of any determination pursuant to paragraph (g)(2)(i) of this section to rebut the presumption described in this paragraph (g) and will provide an explanation of the determination.

(B) Response.

(I) The banking entity may respond to any or all items in the notice described in paragraph (g)(2)(ii)(A) of this section. The response should include any matters that the banking entity would have the Commission consider in deciding whether the banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The

response must be in writing and delivered to the designated Commission official within 30 days after the date on which the banking entity received the notice. The Commission may shorten the time period when, in the opinion of the Commission, the activities or condition of the banking entity so requires, provided that the banking entity is informed promptly of the new time period, or with the consent of the banking entity. In its discretion, the Commission may extend the time period for good cause.

(II) Failure to respond within 30 days or such other time period as may be specified by the Commission shall constitute a waiver of any objections to the Commission's determination.

(C) After the close of banking entity's response period, the Commission will decide, based on a review of the banking entity's response and other information concerning the banking entity, whether to maintain the Commission's determination that banking entity has engaged in proprietary trading or covered fund activities prohibited under subpart B or subpart C. The banking entity will be notified of the decision in writing. The notice will include an explanation of the decision.

(h) *Reservation of authority.* Notwithstanding any other provision of this part, the Commission 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 Commission 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.

66. Revise the Appendix to Part 75 to read as follows:

Appendix to Part 75—Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

a. This appendix sets forth reporting and recordkeeping requirements that certain banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B ("proprietary trading restrictions"). Pursuant to § 75.20(d), this appendix applies to a banking entity that, together with its affiliates and subsidiaries, has significant trading assets and liabilities. These entities are required to (i) furnish periodic reports to the Commission regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and (ii) create and maintain records documenting the preparation and content of these reports. The requirements of this appendix must be incorporated into the banking entity's internal compliance program under § 75.20.

b. The purpose of this appendix is to assist banking entities and the Commission in:

(i) Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

(ii) Monitoring the banking entity's covered trading activities;

(iii) Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the covered trading activities of trading desks engaged in market making-related activities subject to § 75.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading desks that are engaged in permitted trading activity subject to §§ 75.4, 75.5, or 75.6(a)-(b) (i.e., underwriting and market

making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular covered trading activities of the banking entity, and the individual trading desks of the banking entity, to help establish the appropriate frequency and scope of examination by the Commission of such activities; and

(vii) Assessing and addressing the risks associated with the banking entity's covered trading activities.

c. Information that must be furnished pursuant to this appendix is *not* intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

d. In addition to the quantitative measurements required in this appendix, a banking entity may need to develop and implement other quantitative measurements in order to effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § 75.20. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading desk, including types of instruments traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

e. On an ongoing basis, banking entities must carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ 75.4 through 75.6(a)-(b), or that result in a material exposure to high-risk assets or high-risk trading strategies, must be escalated within the banking entity for review, further analysis, explanation to the Commission, and remediation, where appropriate. The quantitative measurements discussed in this appendix should be helpful to banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ 75.2 and 75.3. In addition, for purposes of this appendix, the following definitions apply:

Applicability identifies the trading desks for which a banking entity is required to calculate and report a particular quantitative measurement based on the type of covered trading activity conducted by the trading desk.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

Comprehensive profit and loss means the net profit or loss of a trading desk's material sources of trading revenue over a specific period of time, including, for example, any increase or decrease in the market value of a trading desk's holdings, dividend income, and interest income and expense.

Covered trading activity means trading conducted by a trading desk under §§ 75.4, 75.5, 75.6(a), or 75.6(b). A banking entity may include in its covered trading activity trading conducted under §§ 75.3(e), 75.6(c), 75.6(d), or 75.6(e).

Measurement frequency means the frequency with which a particular quantitative metric must be calculated and recorded.

Trading day means a calendar day on which a trading desk is open for trading.

III. Reporting and Recordkeeping

a. Scope of Required Reporting

1. *Quantitative measurements*. Each banking entity made subject to this appendix by § 75.20 must furnish the following quantitative measurements, as applicable, for each trading desk of the banking entity engaged in covered trading activities and calculate these quantitative measurements in accordance with this appendix:

i. Risk and Position Limits and Usage;

ii. Risk Factor Sensitivities;

iii. Value-at-Risk and Stressed Value-at-Risk;

iv. Comprehensive Profit and Loss Attribution;

v. Positions;

vi. Transaction Volumes; and

vii. Securities Inventory Aging.

2. *Trading desk information*. Each banking entity made subject to this appendix by § 75.20 must provide certain descriptive information, as further described in this appendix, regarding each trading desk engaged in covered trading activities.

3. *Quantitative measurements identifying information*. Each banking entity made subject to this appendix by § 75.20 must provide certain identifying and descriptive information, as further described in this appendix, regarding its quantitative measurements.

4. *Narrative statement*. Each banking entity made subject to this appendix by § 75.20 must provide a separate narrative statement, as further described in this appendix.

5. *File identifying information*. Each banking entity made subject to this appendix by § 75.20 must provide file identifying information in each submission to the Commission 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;

iv. A list of the types of financial instruments and other products purchased and sold by the trading desk; an indication of which of these are the main financial instruments or products purchased and sold by the trading desk; and, for trading desks engaged in market making-related activities under § 75.4(b), specification of whether each type of financial instrument is included in market-maker positions or not included in market-

maker positions. In addition, indicate whether the trading desk is including in its quantitative measurements products excluded from the definition of "financial instrument" under § 75.3(d)(2) and, if so, identify such products;

v. Identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and indication of which of the identified legal entities are the main booking entities for covered trading activities of the trading desk;

vii. For each legal entity that serves as a booking entity for covered trading activities, specification of any of the following applicable entity types for that legal entity:

A. National bank, Federal branch or Federal agency of a foreign bank, Federal savings association, Federal savings bank;

B. State nonmember bank, foreign bank having an insured branch, State savings association;

C. U.S.-registered broker-dealer, U.S.-registered security-based swap dealer, U.S.-registered major security-based swap participant;

D. Swap dealer, major swap participant, derivatives clearing organization, futures commission merchant, commodity pool operator, commodity trading advisor, introducing broker, floor trader, retail foreign exchange dealer;

E. State member bank;

F. Bank holding company, savings and loan holding company;

G. Foreign banking organization as defined in 12 CFR 211.21(o);

H. Uninsured State-licensed branch or agency of a foreign bank; or

I. Other entity type not listed above, including a subsidiary of a legal entity described above where the subsidiary itself is not an entity type listed above;

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. A Risk and Position Limits Information Schedule that provides identifying and descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement, including the name of the limit, a unique identification label for the limit, a description of the limit, whether the limit is intraday or end-of-day, the unit of measurement for the limit, whether the limit measures risk on a net or gross basis, and the type of limit;

2. A Risk Factor Sensitivities Information Schedule that provides identifying and descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement, including the name of the sensitivity, a unique identification label for the sensitivity, a description of the sensitivity, and the sensitivity's risk factor change unit;

3. 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;

4. A Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule; and
5. A Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

d. ***Narrative Statement***

Each banking entity made subject to this appendix by § 75.20 must submit in a separate electronic document a Narrative Statement to the Commission describing any changes in calculation methods used, a description of and reasons for changes in the banking entity's trading desk structure or trading desk strategies, and when any such change occurred. The Narrative Statement must include any information the banking entity views as relevant for assessing the information reported, such as further description of calculation methods used.

If a banking entity does not have any information to report in a Narrative Statement, the banking entity must submit an electronic document stating that it does not have any information to report in a Narrative Statement.

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 Narrative Statement, the Trading Desk Information, the

Quantitative Measurements Identifying Information, and each applicable quantitative measurement electronically to the Commission on the reporting schedule established in § 75.20 unless otherwise requested by the Commission. A banking entity must report the Trading Desk Information, the Quantitative Measurements Identifying Information, and each applicable quantitative measurement to the Commission in accordance with the XML Schema specified and published on the Commission's website.

f. *Recordkeeping*

A banking entity must, for any quantitative measurement furnished to the Commission pursuant to this appendix and § 75.20(d), create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit the Commission to verify the accuracy of such reports, for a period of 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 Commission.

IV. Quantitative Measurements

a. Risk-Management Measurements

1. Risk and Position Limits and Usage

i. *Description:* For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading desk is permitted to take at a point in time, as defined by the banking entity for a specific trading desk. Usage represents the value of the trading desk's risk or positions that are accounted for by the current activity of the desk. Risk and position limits and their usage are key risk management tools used to control and monitor risk taking and

include, but are not limited to, the limits set out in § 75.4 and § 75.5. A number of the metrics that are described below, including "Risk Factor Sensitivities" and "Value-at-Risk," relate to a trading desk's risk and position limits and are useful in evaluating and setting these limits in the broader context of the trading desk's overall activities, particularly for the market making activities under § 75.4(b) and hedging activity under § 75.5. Accordingly, the limits required under § 75.4(b)(2)(iii) and § 75.5(b)(1)(i)(A) must meet the applicable requirements under § 75.4(b)(2)(iii) and § 75.5(b)(1)(i)(A) and also must include appropriate metrics for the trading desk limits including, at a minimum, the "Risk Factor Sensitivities" and "Value-at-Risk" metrics except to the extent any of the "Risk Factor Sensitivities" or "Value-at-Risk" metrics are demonstrably ineffective for measuring and monitoring the risks of a trading desk based on the types of positions traded by, and risk exposures of, that desk.

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 Risk and Position 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. Risk Factor Sensitivities

i. *Description:* For purposes of this appendix, Risk Factor Sensitivities are changes in a trading desk's Comprehensive Profit and Loss that are expected to occur in the event of a change in one or more underlying variables that are significant sources of the trading desk's profitability and risk. A banking entity must report the risk factor sensitivities that are monitored and managed as

part of the trading desk's overall risk management policy. Reported risk factor sensitivities must be sufficiently granular to account for a preponderance of the expected price variation in the trading desk's holdings. A banking entity must provide the following information for each sensitivity that is reported pursuant to this quantitative measurement: the unique identification label for the risk factor sensitivity listed in the Risk Factor Sensitivities Information Schedule, the change in risk factor used to determine the risk factor sensitivity, and the aggregate change in value across all positions of the desk given the change in risk factor.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

3. Value-at-Risk and Stressed 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. For purposes of this appendix, Stressed Value-at-Risk ("Stressed 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 market conditions during a period of significant financial stress.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: For VaR, all trading desks engaged in covered trading activities. For Stressed VaR, all trading desks engaged in covered trading activities, except trading desks whose covered

trading activity is conducted exclusively to hedge products excluded from the definition of "financial instrument" under § 75.3(d)(2).

b. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss Attribution

i. *Description:* For purposes of this appendix, Comprehensive Profit and Loss Attribution is an analysis that attributes the daily fluctuation in the value of a trading desk's positions to various sources. First, the daily profit and loss of the aggregated positions is divided into three categories: (i) profit and loss attributable to a trading desk's existing positions that were also positions held by the trading desk as of the end of the prior day ("existing positions"); (ii) profit and loss attributable to new positions resulting from the current day's trading activity ("new positions"); and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time.

A. The comprehensive profit and loss associated with existing positions must reflect changes in the value of these positions on the applicable day.

The comprehensive profit and loss from existing positions must be further attributed, as applicable, to changes in (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade.

B. 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 that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. Significant unexplained profit and loss must be escalated for further investigation and analysis.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks engaged in covered trading activities.

c. *Positions, Transaction Volumes, and Securities Inventory Aging 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, market value of short securities positions, market value of derivatives receivables, market value of derivatives payables, notional value of derivatives receivables, and notional value of derivatives payables.

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 75.4(a) or § 75.4(b) to conduct underwriting activity or market-making-related activity, respectively.

2. Transaction Volumes

i. *Description*: For purposes of this appendix, Transaction Volumes measures four 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; (iii) trading desks and other organizational units where the transaction is booked in the same banking entity; and (iv) trading desks and other organizational units where the transaction is booked into an affiliated banking entity. For securities, value means gross market value. For derivatives, value means gross notional value. For purposes of calculating the Transaction Volumes quantitative measurement, do not include in the Transaction Volumes calculation for "securities" those securities that are also "derivatives," as those terms are defined under subpart A; instead, report those securities that are also derivatives as "derivatives."[2] Further, for purposes of the Transaction Volumes quantitative measurement, a customer of a

[1] *See* §§ 75.2(i), (bb). For example, under this part, a security-based swap is both a "security" and a "derivative." For purposes of the Positions quantitative measurement, security-based swaps are reported as derivatives rather than securities.

[2] *See* §§ 75.2(i), (bb).

trading desk that relies on § 75.4(a) to conduct underwriting activity is a market participant identified in § 75.4(a)(7), and a customer of a trading desk that relies on § 75.4(b) to conduct market making-related activity is a market participant identified in § 75.4(b)(3).

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 75.4(a) or § 75.4(b) to conduct underwriting activity or market-making-related activity, respectively.

3. Securities Inventory Aging

i. *Description:* For purposes of this appendix, Securities Inventory Aging generally describes a schedule of the market value of the trading desk's securities positions and the amount of time that those securities positions have been held. Securities Inventory Aging must measure the age profile of a trading desk's securities positions for the following 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. Securities Inventory Aging includes two schedules, a security asset-aging schedule, and a security liability-aging schedule. For purposes of the Securities Inventory Aging quantitative measurement, do not include securities that are also "derivatives," as those terms are defined under subpart A.[3]

ii. *Calculation Period:* One trading day.

iii. *Measurement Frequency:* Daily.

iv. *Applicability*: All trading desks that rely on § 75.4(a) or § 75.4(b) to conduct underwriting activity or market-making related activity, respectively.

[3] *See* §§ 75.2(i), (bb).

Dated: May 31, 2018

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Joseph M. Otting,
Comptroller of the Currency

By order of the Board of Governors of the Federal Reserve System, May 30, 2018.

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Ann E. Misback,
Secretary of the Board.

Dated at Washington, D.C. on May 31, 2018.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

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Valerie Jean Best
Assistant Executive Secretary

By the Securities and Exchange Commission.

Date: June 5, 2018

Brent J. Fields
Secretary

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Robert Sidman,
Deputy Secretary of the Commodity Futures Trading Commission

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