STROOCK
SPECIAL BULLETIN

Proposed Revisions to the Volcker Rule's Implementing Rules – Select Proposals and Open Questions

July 2, 2018

On May 30, 2018, the Board of Governors of the Federal Reserve System, together with the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency at the Department of Treasury, and the Securities and Exchange Commission (collectively, the "Agencies"), released their long awaited package of proposed revisions, amendments, and requests for comment to rules and regulations that prohibit and/or restrict banking entities from proprietary trading, ownership in, and relationships with, covered funds, including what are commonly known as hedge funds and private equity funds, subject to certain exemptions (the "Proposals"). Specifically, the Agencies are proposing:

1. Three Tiers of Compliance Obligations for Banking Entities
2. Modifications to the Definition of Trading Accounts
3. Presumption of Compliance at the Trading Desk Level
4. Relief with respect to Liquidity Management Exemption Requirements
5. Flexibility with respect to Underwriting and Market-Making Exemptions
6. Relief with respect to Risk-Mitigating Hedging Exemption Requirements
7. Updates regarding Trading Outside the U.S.
8. Covered Funds and Exemptions
9. Covered Funds Solely Outside the U.S.
10. Simplifying the Metrics Reporting Requirements

As it currently stands, Section 13 of the Bank Holding Company Act (the "BHCA"), more commonly known as the "Volcker Rule", which was added to the BHCA almost eight years ago when Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted on July 21, 2010, 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 covered funds, including hedge funds and private equity funds, subject to certain exemptions. The final implementing rules were adopted in December 2013.

The Proposals represent a major step in the Agencies' coordinated effort to recalibrate the Volcker Rule's implementing rules and, in particular, focus more on making the implementing rules less burdensome than on modifying the intent and substance of the Volcker Rule itself. In this respect, banking entities are well advised to continue to comply with all aspects of the Volcker Rule applicable to them regardless of the tiered compliance obligations that apply to them. In releasing the Proposals, the Agencies cite a desire to provide greater clarity and certainty about what activities are prohibited and improve how banking entities allocate compliance resources. By tailoring compliance obligations to three categories of banking entities, the Proposals are intended to increase efficiency, reduce demands on available compliance resources, and allow banking entities to more efficiently provide services to clients. The Agencies request comment on more than 350 questions relating to the implementation of the Volcker Rule. The Agencies provide for a 60-day comment period from the date the Proposals are published in the Federal Register.

This *Stroock Special Bulletin* identifies and briefly summarizes certain key effects the Proposals will have on banking entities if the Proposals are enacted in their current form and select questions raised by the Proposals.

Categories of Banking Entities

The Proposals tailor a banking entity's compliance obligations under the Volcker Rule to its size and complexity, with greater compliance obligations for banking entities with significant impact in the U.S in an effort to minimize the risks posed by such banking entities. In their current form, the Proposals will create three categories of banking entities with decreasing tiers of compliance obligations depending on the category of banking entity: (1) banking entities with "significant trading assets and liabilities," which, together with their affiliates and subsidiaries, have trading assets and liabilities equal to or exceeding $10 billion, (2) banking entities with "moderate trading assets and liabilities," which, together with their affiliates and subsidiaries, do not meet the thresholds in the above "significant" category or the below "limited" category, and (3) banking entities with "limited trading assets and liabilities", which, together with their affiliates and subsidiaries, have trading assets and liabilities of less than $1 billion. The Proposals eliminate the enhanced minimum standards for compliance programs set forth in Appendix B of the implementing rules.

Measurement of Each Category

For each category, the Agencies propose that trading assets and liabilities be measured by calculating the average gross sum of the relevant trading assets and liabilities over the previous consecutive four quarters, as measured as of the last day of each quarter, but excluding from such calculations any obligations of, or obligations guaranteed by, the U.S. or any agency of the U.S.

Nuance with respect to Foreign Banking Entities

Notably, the Proposals suggest that certain entities will be treated differently depending on whether they are being tested for different categories. For example, for the "significant" category test, banking entities that are part of foreign banking organizations ("FBOs") only have to aggregate the trading assets and liabilities of their U.S. operations. However, for the "limited" category test, banking entities that are part of an FBO must aggregate the relevant trading assets and liabilities world-wide. As a result, many large FBOs with substantial assets outside of the U.S. will fall in the "moderate" category even if they have limited U.S. assets.

Banking Entities with Significant Trading Assets and Liabilities

A banking entity with significant trading assets and liabilities would be required to establish a six-pillar compliance program commensurate with the size, scope, and complexity of its activities and business structure that meets six specific requirements in the current Volcker 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. With the elimination of Appendix B, the Proposals would essentially permit a banking entity with significant trading assets and liabilities to integrate compliance programs meeting these requirements into its existing compliance regime. Such a banking entity would still be subject to the metrics reporting requirements, the covered fund documentation requirements, and the CEO attestation requirement.

Banking Entities with Moderate Trading Assets and Liabilities

In contrast, a banking entity that falls within the "moderate" category will be required to maintain a compliance program that includes in its existing compliance policies and procedures appropriate references to the Volcker Rule and the implementing rules given such banking entity's activities, size, scope, and complexity (as opposed to the full six-pillar compliance program requirements). Banking entities within the "moderate" category will also be subject to CEO attestation requirements.

Banking Entities with Limited Trading Assets and Liabilities

Lastly, banking entities that fall within the "limited" category will still be required to comply with the Volcker Rule and its implementing releases but have a presumption of compliance. They will be presumed to comply with the proprietary trading and covered fund subparts of the Volcker Rule implementing rules and will have no affirmative obligation to demonstrate compliance on an ongoing basis 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. In contrast to the "significant" and "moderate" category, banking entities in the "limited" category will not be subject to a CEO attestation requirement.

How many banking entities will be subject to the "significant" category and "moderate" category standards?

The Agencies expect that the total number of distinct banking entities that fall within the "significant" category and "moderate" category will be approximately 40 banking organizations, and that a large majority of banking entities will instead fall within the "limited" category. If this holds true, a large majority of banking entities will be subject to a lower compliance standard with respect to Volcker Rule obligations.

The chart below highlights the proposed categories of banking entities and key compliance obligations.

Categories of Banking Entities

Banking Entities with "Significant Trading Assets and Liabilities"	**Compliance Program**
Banking entities that, together with their affiliates and subsidiaries, have trading assets and liabilities (excluding obligations of or guaranteed by the U.S.	• Must maintain a six-pillar compliance program (including written policies and procedures, internal controls, management framework, independent testing, training, and records), commensurate with the size, scope, and

or any agency of the U.S.) equal to or exceeding $10 billion. The trading assets and liabilities are calculated as the average gross sum over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters. Foreign Banking Organizations: Banking entities that are part of an FBO need only to aggregate the trading assets and liabilities (excluding obligations of or guaranteed by the U.S. or any agency of the U.S.) of its consolidated U.S. operations including its U.S. branches and agencies to determine whether they meet the $10 billion threshold.	complexity of their activities and business structure, which can be integrated into their existing compliance regime. **CEO Attestation** • Required to comply with the CEO attestation requirement. **Proprietary Trading Exemptions** • Must still comply with a greater set of requirements than other banking entities to meet the conditions of the exemptions for underwriting, market-making, and risk-mitigating hedging activities. • Must still design hedging to reduce or otherwise mitigate one or more specific, identifiable risks but no longer have the requirement that the hedging activity “demonstrably reduces” or “significantly mitigates” risk. • No longer have hedging correlation analysis requirement. • Reduced enhanced documentation requirements associated with risk-mitigating hedging transactions that are conducted by one desk to hedge positions at another desk. **Covered Funds** • Must still meet covered fund documentation requirements
Banking Entities with “Moderate Trading Assets and Liabilities” Banking entities that do not meet the “significant trading assets and liabilities” or “limited trading assets and liabilities” test. Generally, banking entities with “moderate trading assets and liabilities” have trading assets and liabilities (excluding obligations of or guaranteed by the U.S. or any agency of the U.S.) of $1 billion or more but less than $10 billion.	**Compliance Program** • Must establish a simplified compliance program and include in its existing compliance policies and procedures appropriate references to the requirements of Volcker Rule and the implementing rules as appropriate given its activities, size, scope, and complexity. **CEO Attestation** • Must comply with the CEO attestation requirement. **Proprietary Trading Exemptions** • Must comply with a more tailored set of compliance requirements under the underwriting, market-making, and risk-mitigating hedging exemptions.

	- The specific compliance program requirements for underwriting and market-making are eliminated. - Must only require 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. **Covered Funds** - No covered fund documentation requirements.
Banking Entities with "Limited Trading Assets and Liabilities" Banking entities that, together with their affiliates and subsidiaries, have trading assets and liabilities (excluding trading assets and liabilities involving obligations of, or guaranteed by, the U.S. or any agency of the U.S.) of less than $1 billion. The trading assets and liabilities are calculated as the average gross sum over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters. Foreign Banking Organizations: Banking entities that are part of an FBO must aggregate the trading assets and liabilities (excluding obligations of or guaranteed by the U.S. or any agency of the U.S.) world-wide for purposes of determining if they meet this test.	**Compliance Program** - Presumed to be in compliance with proprietary trading and covered fund subparts of the Volcker Rule implementing rules - No affirmative obligation to demonstrate compliance on an ongoing basis although the Agencies may rebut the presumption of compliance as a result of an examination or audit and require demonstration of compliance. **CEO Attestation** - Do not have to provide a CEO attestation. **Proprietary Trading Exemptions** - The specific compliance program requirements for underwriting and market-making are eliminated. **Covered Funds** - No covered fund documentation requirements.

Trading Accounts – Proposed Modifications to the Definition

The Proposals would broaden the definition of "trading accounts", which are subject to the Volcker Rule, primarily by eliminating the short-term intent test and creating a new accounting test. In doing so, the Proposals will require banking entities to modify their approach to meet the expanded threshold question of whether a position in a financial instrument is a "trading account" subject to the ban on proprietary trading under the Volcker Rule. Under the Volcker Rule's existing implementing rules, the definition of "trading account" includes three tests – a "short-term intent" test, a "market risk capital" test and a "dealer" test. However, citing an overlap with the other two tests, the Proposals eliminate the "short-term intent" test. Without further clarification, this elimination raises the possibility that a "trading account" will no longer include 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. However, the statement that these accounts are already covered by the other tests suggests they will continue to be treated as trading accounts.

Elimination of Rebuttable Presumption

Separately, the Proposals also would eliminate the rebuttable presumption that any position held for fewer than 60 days or whose risk is transferred in less than 60 days is for a trading account. Although not explicitly approved by the Agencies, under the existing Volcker Rule implementing rules certain banking entities use the rebuttable presumption to create books of positions in which all instruments are held for more than 60 days and do not treat such accounts as trading accounts subject to the Volcker Rule. If the Proposals are enacted in their current form, banking entities will need to reevaluate such accounts to determine whether they still fall outside the definition of trading account.

Market Risk Test Applies to Foreign Trading Positions

The Proposals also clarify that the market risk test further applies to foreign banking entity trading positions covered by similar market risk capital rules imposed by foreign regulators. This "clarification" is likely in response to the position of certain non-U.S. banks that the market risk test, if read literally, does not explicitly apply to such foreign positions.

New "Accounting" Test

The Proposals also include a new "accounting" test. Under this new test, a trading desk that buys or sells a financial instrument 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. Under the new test, loan-related swaps that are not currently considered trading accounts could be so considered. This new test raises the possibility that a number of positions currently not considered trading accounts for purposes of the Volcker Rule could be considered trading accounts if the Proposals are enacted in their current form.

Trading Accounts – Presumption of Compliance at the Trading Desk Level

In order to reduce the burden of the new trading account definition, the Proposals introduce a presumption of compliance at the trading desk level for accounts that do not meet the market risk test or the dealer test. Each trading desk that purchases or sells financial instruments for a trading account pursuant to the accounting test may elect to calculate the net gain or loss on such 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.

Under this proposal, if the sum of the absolute values of the daily net gain and loss figures for the preceding 90-calendar-day period (calculated on a rolling daily basis) 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 Volcker Rule on an ongoing basis.

Practitioners will want to keep in mind that this is not a *de minimis* exemption for proprietary trading. Instead, any trading desk relying on this presumption will still be required to comply with the prohibition against proprietary trading and will be subject to the same sanctions for any violation of the prohibition against proprietary trading.

Liquidity Management Exclusion

The Proposals modify the existing liquidity management exclusion to the definition of trading accounts, which historically has been a challenging exclusion with which to comply. The existing implementing rules only permit the trading of securities for purposes of the exclusion and do not include derivatives. As a result, the full scope of bank asset liability management and treasury activities generally do not fall under the narrow definition of liquidity management. In particular, non-U.S. banks operating in the U.S. and U.S. banks operating outside the U.S. that rely on head office funding for the foreign offices are unable to treat the required foreign exchange swap transactions as part of the liquidity management exclusion and instead are forced to rely on other exclusions such as the risk-mitigating hedging exemption. However, the Proposals change this by permitting the purchase or sale of foreign exchange forwards, foreign exchange 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. This would make the liquidity management exclusion more closely track how banking entities manage liquidity. Prior to the issuance of the Proposals, the authors of this Stroock Special Bulletin worked extensively to outline for the Agencies the need for this relief in order to permit continued cross-border funding for global banking organizations.

Underwriting and Market-Making Exemptions

The Proposals modify the compliance requirements to engage in permitted underwriting and market-making, which should create more capacity for banking entities to engage in such transactions.

Under the Proposals, rather than meeting onerous quantitative requirements to demonstrate that such underwriting and market-making activity is designed so as not to exceed the reasonably expected near-term demands of clients, customers, or counterparties ("RENTD"), a banking entity would benefit from a presumption that trading within internally set risk limits satisfies the requirement that permitted underwriting and market making-related activities are designed so as not to exceed RENTD. Risk limits would not have to be based on any specific or mandated analysis, but, rather, a banking entity would establish the risk limits according to its own internal analyses and processes. The banking entity must comply with its internal risk limits and must report to regulators when a trading desk exceeds or increases its risk limits. Reliance on internal risk limits would be especially beneficial in the derivatives context where defining RENTD, inventory and its related metrics have been challenging to banking entities.

Consistent with the current Volcker Rule, banking entities 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 and market-making exemptions. However, the specific compliance program requirements for banking entities that have moderate or limited trading assets and liabilities would be eliminated. Such entities would still have to comply with the market-making and underwriting rules but would have more flexibility with respect to implementing a compliance plan.

Risk-Mitigating Hedging Exemption

The Proposals significantly reduce the compliance burden of the risk-mitigating hedging exemption.

For banking entities within the "significant" category, the Proposals would maintain many of the Volcker Rule's requirements, including the requirement that the hedging activity be designed to reduce or otherwise mitigate one or more specific, identifiable risks. However, the Proposals would eliminate the current requirement that the hedging activity "demonstrably reduces" or otherwise "significantly mitigates" risk, reduce the enhanced 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 correlation analysis requirement.

For banking entities within the "moderate" and "limited" categories, the Proposals would remove all requirements including the requirement for a separate internal compliance program for risk-mitigating hedging, 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.

Trading Outside the U.S.

For the exemption for trading outside the U.S. by foreign banking entities, the Proposals eliminate the requirement that the transaction not be with or through a U.S. counterparty so that a foreign banking entity would be able to rely on the exemption for trades with a U.S. counterparty. The exemption still requires that the banking entity engaging as principal in the purchase or sale (including relevant personnel) of financial instruments not be located in the U.S. or organized under the laws of the U.S. 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 U.S. or organized under the laws of the U.S. or of any State.

However, personnel of the banking entity or any of its affiliates that arrange, negotiate, or execute such purchase or sale may be located in the U.S., and financing for the banking entity's purchase or sale may be provided, directly or indirectly, by any branch or affiliate that is located in the U.S. or organized under the laws of the U.S. or of any State.

These changes may potentially give foreign banking entities a competitive advantage to the extent that a domestic banking entity would be subject to additional compliance burdens or restrictions if it were to engage in the same transaction. We will monitor whether domestic banking entities object to this.

Covered Funds

As currently drafted, the Proposals do not generally amend the covered fund definitions and exemptions and all categories of banking entities remain subject to the covered fund provisions of the Volcker Rule. The Proposals instead ask for comments on the definition of covered funds and its exclusions, including with respect to foreign public funds, securitizations, small business investment companies, municipal securities tender option bond vehicles, family wealth management vehicles and joint ventures. After soliciting this industry feedback, the Proposals include a more modest set of revisions as highlighted below.

Underwriting or Market-Making Exemption

The Proposals amend the restrictions related to underwriting or market making-related activities with respect to third party covered funds. For a covered fund that the banking entity does not organize or offer, the Proposals 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.

Risk-Mitigating Hedge Exemption

The Proposals would also 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.

Covered Funds Solely Outside the U.S.

Like the exemption for proprietary trading outside the U.S., the Proposals eliminate the financing test of the foreign fund exemption and would permit

U.S. funding. Under the current financing test for the exemption, no financing for the banking entity's ownership or sponsorship of the fund may be provided, directly or indirectly, by any branch or affiliate that is located in the U.S. or organized under the laws of the U.S. or of any State. The elimination of this financing test will allow banking entities to permit U.S. funding while remaining eligible for the foreign fund exemption.

In addition, the Proposals codify existing guidance regarding when a foreign fund is offered for sale or sold to a resident of the U.S. The Proposals provide that an ownership interest in a covered fund is not offered for sale or sold to a resident of the U.S. 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 U.S. 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 restriction to participate in any offer or sale by the covered fund, to have ownership interests in the covered fund. This makes 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) rather than the activities of unaffiliated third parties.

Note that this interpretation could not be used to have third parties offer unregistered fund securities in the U.S. as the fund could become a U.S. covered fund as a result.

Questions Regarding the Covered Fund Exemptions

Interestingly, while the Proposals request comments on the covered fund exemptions, the Proposals largely leave the covered fund exemptions alone. In light of the challenges in compliance with the covered fund exemptions set forth in the Volcker Rule itself and the reliance of the industry on exemptions from the Investment Company Act other than Sections 3(c)(1) and 3(c)(7), the lack of proposed amendments to the covered fund exemptions creates both concern and an opportunity for the financial services industry to propose their own amendments.

Simplifying the Metrics Reporting Requirements

The Proposals revise and simplify the metrics reporting requirements to make them applicable to a wider range of instruments, in particular derivative instruments. As a result, certain metrics have been limited to market-making and underwriting desks while other metric have been eliminated. For example, the Customer-Facing Trade Ratio would be replaced with a new Transaction Volumes metric to more precisely cover different types of trading desk transactions. Separately, the Inventory Turnover metric—which was not relevant to derivative positions—is being replaced with a new Positions metric, which will measure the value of all securities and derivatives positions. In a related change, Inventory aging data has been eliminated for derivatives. Please see the end of the Summary of Key Amendments below for more detailed information concerning certain key changes to the metrics reporting requirements.

Summary of Key Amendments

Trading Accounts	• The short-term intent test for the trading account test (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) is eliminated. • The short term 60-day presumption is eliminated. • There is a new accounting test to the trading account definition under which a trading desk that buys or sells a financial instrument that is recorded at fair value on a recurring basis under applicable accounting standards would be doing so for the "trading account". • For the accounting test, there is a presumption of compliance at the trading desk level if the sum of the absolute values of the daily net gain and loss figures for the preceding 90-calendar-day period (calculated on a rolling daily basis) does not exceed $25 million.
Liquidity Management	• Foreign exchange forwards, foreign exchange swaps, and physically settled cross-currency swaps may be used to the same extent as securities under the liquidity management program exemption.
Trade Errors	• Transactions made to correct errors made in connection with customer-driven or other permissible transactions and transferred to a separately-managed trade error account are excluded from the definition of proprietary trading.
Underwriting and Market-Making	• There is a presumption that trading within internally set risk limits satisfies the requirement that permitted underwriting and market making-related activities are designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties ("RENTD").
Risk Mitigating Hedging	• All banking entities no longer have the requirement that the hedging activity "demonstrably reduces" or "significantly mitigates" risk. • All banking entities no longer have to conduct correlation analysis of hedging. • Banking entities with significant trading assets and liabilities ○ Must still design hedging to reduce or otherwise mitigate one or more specific, identifiable risks; and ○ Have reduced enhanced 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. • Banking entities with moderate or limited trading assets and liabilities would only have 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.
Trading Outside the U.S.	• Personnel of the banking entity or any of its affiliates that arrange, negotiate, or execute such purchase or sale may be located in the U.S. so long as the banking entity (including relevant personnel) that makes the decision to purchase or sell as principal is not located in the U.S. or organized under the laws of the U.S. or of any state. • Financing for the banking entity's purchase or sale may be provided, directly or indirectly, by any branch or affiliate that is located in the U.S. or organized under the laws of the U.S. or of any state. • The counterparty may be a U.S. person.
Covered Funds	• The Proposals do not generally amend the covered fund definitions and exemptions. All categories of banking entities remain subject to the covered fund provisions of the Volcker Rule. • For a covered fund that the banking entity does not organize or offer, the Proposals 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. • The Proposals would 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 to facilitate the exposure by the customer to the profits and losses of the covered fund.
Covered Funds – Documentation Requirements	• No covered fund documentation requirements for banking entities in the "moderate" and "limited" categories.
Covered Funds – Solely Outside the U.S.	• The Proposals eliminate the financing test of the foreign fund exemption and would permit U.S. funding. • The Proposals state an ownership interest in a covered fund is not offered for sale or sold to a resident of the U.S. 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 U.S. in which the banking entity or any affiliate of the banking entity participates.
Prime Brokerage Transactions	• The Proposals change the date for CEO certification required by the exemption for prime brokerage transactions with a covered fund in which a covered fund managed, sponsored, or advised by a banking entity has taken an ownership interest. The banking entity must provide the CEO certification annually no later than March 31 of the relevant year.
Futures Commissions Merchants ("FCM")	• The Proposals codify the CFTC's letter providing 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 certain services including investment management services.
Metrics Reporting Requirements	• Metrics that were applicable to securities but were not meaningful with respect to derivatives or other instruments have been amended accordingly. • Certain metrics have been limited to market-making and underwriting desks while other metrics have been eliminated. • Certain key changes are as follows: ○ The Customer-Facing Trade Ratio has been replaced with a new Transaction Volumes metric to more precisely cover types of trading desk transactions with counterparties; ○ Inventory Turnover has been replaced with a new Positions metric, which measures the value of all securities and derivatives positions; ○ Inventory Aging Data for derivatives has been eliminated; and ○ The requirement that banking entities establish and report limits on Stressed Value-at-Risk at the trading desk-level has been eliminated. • Banking entities will be required to provide qualitative information specifying for each trading desk the types of financial instruments traded, the types of covered trading activity the trading desk conducts, and the legal entities into which the trading desk books trades.

Questions Regarding Related Proposed Rules

Another notable omission is that the Proposals do not implement the amendments to the Volcker Rule related to the definition of "banking entity" and the naming of covered funds set forth in the Economic Growth, Regulatory Relief, and Consumer Protection Act enacted on May 24, 2018, which will be subject to a separate rulemaking. But the Proposals do codify much of the guidance issued by the Agencies after the release of the original implementing rules.

What is next?

The Proposals remain in draft form and the Agencies are requesting comment within 60 days after the Proposals are published in the Federal Register. Given the scope and the number of questions included in the Proposals, we expect industry participants and trade groups to provide a substantial amount of comments and the final revised implementing rules may be markedly different than the current Proposals in some respects. In point of fact, an SEC Commissioner quickly issued a public statement opposing the Proposals shortly after their release.[1] While this alone is not indicative of whether the Proposals will succeed or not, we anticipate that the comments received by the Agencies may change the course of the final rulemaking. A key question the Agencies should keep in mind is whether the Proposals strike the right balance between protecting the banking system from the risky transactions the Volcker Rule is meant to prohibit while giving banking entities the ability to provide the services and products that are desired by customers in the marketplace. Stroock will continue to monitor the progress of the Proposals and we encourage those with questions to contact the authors of this Stroock Special Bulletin for more information.

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[1] Statement on Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, June 5, 2018, available at https://www.sec.gov/news/public-statement/statement-stein-060518-2

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