Commodity Futures Trading Commission
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CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Questions Regarding Certain Requirements under Section 13 of the Bank Holding Company Act of 1956 and Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act added a new section 13 to the Bank Holding Company Act of 1956 ("BHC Act"), commonly referred to as the Volcker rule, that generally prohibits insured depository institutions and any company affiliated with an insured depository institution from engaging in proprietary trading and from acquiring or retaining ownership interests in, sponsoring, or having certain relationships with a hedge fund or private equity fund. These prohibitions are subject to a number of statutory exemptions, restrictions, and definitions.

The Commodity Futures Trading Commission ("CFTC") is working closely with the other agencies charged with implementing the requirements of section 13, including the Federal Reserve Board ("Board"), Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission (each an "Agency" and collectively with the CFTC "the Agencies"). While these frequently asked questions ("FAQs") apply to banking entities for which the CFTC has jurisdiction under section 13 of the BHC Act, they have been developed by staffs of the Agencies and substantively identical versions will appear on the public websites of each Agency.

Metrics Reporting Date

1. To comply with the requirement to record and report quantitative measurements in § 75.20(d) and Appendix A, when must a banking entity with $50 billion or greater in trading assets and liabilities begin to measure and record the required metrics? When must the banking entity begin to report metrics data to the CFTC?

A banking entity with trading assets and liabilities of at least $50 billion, as calculated under § 75.20(d)(1), must begin to measure and record the required metrics on a daily basis starting July 1, 2014. As explained below, this banking entity must report its daily metrics recorded during the month of July to the CFTC by September 2, 2014.

Section 75.20(d)(2) provides that the threshold for reporting quantitative measurements under § 75.20(d)(1) is $50 billion beginning on June 30, 2014. This means that the first day for which daily metrics must be measured and recorded by a banking entity at the $50 billion threshold is July 1, 2014.

The final rule requires a banking entity at or above the $50 billion threshold to report metrics data for each calendar month within 30 days of the end of the month unless the CFTC notifies the banking entity in writing that it must report on a different basis. However, if the reporting deadline occurs on a Saturday, Sunday, or federal holiday, then a banking entity may report the data on the next business day following the reporting deadline. Thus, the relevant banking entity must collect metrics data for the month of July and report that data by September 2, 2014. This banking entity has until September 2, 2014 to report metrics data under

these circumstances because August 30, 2014 (which is 30 days after July 31, 2014) is a Saturday, and the following Monday on September 1, 2014 is a federal holiday. Beginning with information for the month of January 2015, the final rule requires this banking entity to report metrics data within 10 days of the end of each calendar month, unless the CFTC notifies the banking entity in writing that it must report on a different basis.

Certain of the required metrics have a calculation period of 30 days, 60 days, and 90 days. For these measurements, the initial metrics report for the month of July may provide data for only a 30 day calculation period. Likewise, the metrics report due by September 30, 2014 may provide data for only a 30 day and 60 day calculation period. Beginning with the report due October 30, 2014, metrics reports must include data for all required calculation periods.

Trading Desk

2. May a trading desk span multiple affiliated banking entities? If a trading desk spans multiple affiliated banking entities, to which Agency(ies) should a banking entity report metrics?

The final rule defines trading desk to mean the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof. As discussed in the preamble to the final rule, the Agencies expect that a trading desk would be managed and operated as an individual unit and should reflect the level at which the profit and loss of the traders is attributed. This approach allows more effective management of risks of trading activity by requiring the establishment of limits, management oversight, and accountability at the level where the trading activity occurs. It also allows banking entities to tailor the limits and procedures to the type of instruments traded and markets served by each trading desk.

The definition of "trading desk" specifically recognizes that the desk may buy or sell financial instruments "for the trading account of a banking entity or an affiliate thereof." The preamble to the final rule explains that a trading desk may span more than one legal entity and thus employees may be working on behalf of multiple affiliated legal entities. Additionally, trades and positions managed by the desk may be booked in different affiliated entities. The rules require that if a single trading desk books positions in different affiliated legal entities, it must have records that identify all positions included in the trading desk's financial exposure and the legal entities where such positions are held.

Appendix A to the final rule provides that a banking entity with significant trading assets and liabilities must furnish periodic reports to the Agencies regarding a variety of quantitative measurements of their covered trading activities. If a trading desk spans multiple legal entities, it must report quantitative measurements to each of the agencies with jurisdiction under section 13 of the BHC Act over any of the entities. For a trading desk that spans multiple affiliated banking entities, the quantitative measurements of Appendix A should be calculated at the level of the entire desk; calculations do not need to be performed separately for each subset of positions booked at the various banking entities that compose the trading desk. As indicated above, this same set of desk-wide measurements should be reported to each Agency that has authority under section 13 of the BHC Act over any of the affiliated entities that compose the trading desk so that the Agency may understand the context of the trading activity and discharge its responsibility for the legal entity that the Agency supervises or regulates.

Conformance Period

3. How do the requirements of section 13 of the BHC Act and the final rule apply to a banking entity during the conformance period? For instance, must a banking entity

deduct its investment in a covered fund from its tier 1 capital prior to the end of the conformance period?

The Board extended the statute's conformance period until July 21, 2015 ("Board Conformance Order").[1] The Board also has issued a statement of policy in which the Board clarified the activities and investments that are permissible during the conformance period.[2]

As explained in the Board Conformance Order, a banking entity must conform all of its proprietary trading activities and covered fund activities and investments to the prohibitions and requirements of section 13 and the final rule by no later than the end of the conformance period. During the conformance period, a banking entity is expected to engage in good-faith efforts, appropriate for its activities and investments that will result in the conformance of all of its activities and investments to the requirements of section 13 and the final rule no later than the end of the conformance period. Good-faith efforts include evaluating the extent to which the banking entity is engaged in activities and investments that are covered by section 13 and the final rule, as well as developing and implementing a conformance plan that is appropriately specific about how the banking entity will fully conform all of its covered activities and investments by the end of the conformance period. In addition, under the Board Conformance Order, banking entities that have stand-alone proprietary trading operations are expected to promptly terminate or divest those operations. Moreover, banking entities should not expand activities and make investments during the conformance period with the expectation that additional time to conform those activities or investments will be granted.

As an example of how the conformance period works in practice, section 13(d)(4) of the BHC Act and § 75.12(d) of the final rule require a banking entity to deduct from the banking entity's tier 1 capital, as determined under § 75.12(c)(2) of the final rule, its permitted investments in all covered funds. A banking entity would not be required to make this deduction until the end of the conformance period, which is currently July 21, 2015. As noted above, a banking entity is expected to engage in good faith efforts during the conformance period so that it can comply with this requirement no later than the end of the conformance period. Notably, as specified in the final rule, certain metrics reporting requirements will be in place before the end of the conformance period for banking entities with $50 billion or greater in trading assets and liabilities.

Loan Securitization Servicing Assets

4. Are the "rights or other assets" described in § 75.10(c)(8)(i)(B) ("servicing assets") limited to "permitted securities," or can other assets be servicing assets for purposes of the loan securitization exclusion?

The exclusion from the definition of covered fund for loan securitizations provides that, in addition to loans, a loan securitization may hold rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset meets the requirements of § 75.10(c)(8)(iii) of the final rule.

Under the final rule, servicing assets may be any type of asset. However, any servicing asset that is a security must be a permitted security under § 75.10(c)(8)(iii). Permitted securities under this section include cash equivalents and securities received in lieu of debts previously contracted as set forth in § 75.10(c)(8)(iii). The

[1] See Board Order Approving Extension of Conformance Period, *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf.

[2] See Statement of Policy Regarding the Conformance Period for Entities Engaged in Proprietary Trading or Private Equity Fund and Hedge Fund Activities, 77 Fed. Reg. 33,949 (June 8, 2012).

preamble to the final rule provides additional detail on the meaning of cash equivalents, noting that the Agencies interpret "cash equivalents" to mean high quality, highly liquid short term investments whose maturity corresponds to the securitization's expected or potential need for funds and whose currency corresponds to either the underlying loans or the asset-backed securities.

Foreign Public Fund Seeding Vehicles

5. The final rule excludes from the definition of covered fund a registered investment company and business development company, including an entity that is formed and operated pursuant to a written plan to become one of these entities. Would an entity that is formed and operated pursuant to a written plan to become a foreign public fund receive the same treatment?

Section 75.10(c)(12) of the final rule explicitly excludes an issuer that is registered as an investment company under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), or that is formed and operated pursuant to a written plan to become a registered investment company ("RIC") in accordance with the banking entity's compliance program as described in § 75.20(e)(3), and that complies with the requirements of section 18 of the Investment Company Act (15 U.S.C. 80a-18).[3] Section 75.10(c)(1) of the final rule also excludes from the definition of covered fund a foreign public fund that is an issuer that is organized or established outside of the United States; is authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction; and sells ownership interests predominantly through one or more public offerings outside of the United States. Foreign public funds that meet these qualifications are therefore treated the same as RICs for purposes of the definition of "covered fund" under the final rule. Although the final rule excludes from the definition of covered fund certain seeding vehicles that will become RICs, as discussed above, the final rule does not address a seeding vehicle that will become a foreign public fund.

Staffs of the Agencies believe that, with respect to determining whether an entity is a covered fund, it would be appropriate that an issuer that will become an excluded foreign public fund be treated during its seeding period the same as an issuer that will become an excluded RIC. Accordingly, staffs of the Agencies do not intend to advise the Agencies to treat as a covered fund under the final rule an issuer that is formed and operated pursuant to a written plan to become a qualifying foreign public fund. 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 vehicle will operate as a seeding vehicle, the banking entity's plan to market the vehicle to third-party investors and convert it into a foreign public fund within the time period specified in § 75.12(a)(2)(i)(B) of subpart C, and the banking entity's plan to operate the seeding vehicle in a manner consistent with the investment strategy, including leverage, of the issuer upon becoming a foreign public fund. For purposes of the definition of covered fund, this would treat an issuer that becomes a qualifying foreign public fund the same as an issuer that becomes a RIC during the seeding period for the fund.

Namesharing Prohibition

6. Section 75.11 of the final rule provides that a banking entity may acquire and retain an ownership interest in a covered fund that the banking entity organizes and offers, subject to a number of conditions. Among other things, these conditions require that the covered fund, for corporate, marketing, promotional or other purposes does not

[3] The final rule also explicitly excludes an issuer that has elected to be regulated as a business development company ("BDC") pursuant to section 54(a) of that Act (15 U.S.C. 80a-53) and has not withdrawn its election, or that is formed and operated pursuant to a written plan to become a BDC as described in § 75.20(e)(3) and that complies with the requirements of section 61 of the Investment Company Act of 1940 (15 U.S.C. 80a-60).

share the same name or a variation of the same name with the banking entity (or an affiliate thereof). What does it mean for a covered fund to share the same name or a variation of the same name with a banking entity?

A covered fund that is organized and offered by "banking entity A" may not share the same name or a variation of the same name as "banking entity A," nor may it share the same name or a variation of the same name as any affiliate of "banking entity A." Additionally, the final rule prohibits a covered fund from using the word "bank" in its name.

Similar restrictions on a fund sharing the same name, or variation of the same name, with an insured depository institution or company that controls an insured depository institution or having the word "bank" in its name, have been used previously in order to prevent customer confusion regarding the relationship between such companies and a fund.[4] In order to comply with § 75.11(a)(6) of the final rule and not be considered to share the same name or variation of the same name with a banking entity, the name of a covered fund must be sufficiently distinct from the name of the banking entity that the covered fund's use of the name would not likely lead to customer confusion regarding the relationship between the banking entity and the covered fund. For instance, a covered fund would generally be considered to share the same name or a variation of the same name with a banking entity if the name of the fund features the same root word, initials or a logo, trademark, or other corporate symbol that is also used by, or that clearly references a connection with, the banking entity, including any affiliate of the banking entity. Additionally, materials used to market, promote, or offer the fund may not contain any statements that would mislead an investor into thinking that the banking entity or any of its affiliates, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or any covered fund in which such covered fund invests.

[4] See, e.g., 12 CFR 225.125(f); Bank of Ireland, 82 Fed. Res. Bull. 1129, 1132 (1996).