



Commodity Futures Trading Commission

Office of Public Affairs

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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, 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.

Termination of Market-Making Activity: Treatment of Residual Positions

1. If a banking entity exits a market-making business permitted under the final rule, how may the banking entity sell or unwind its residual market-making positions? How may the banking entity hedge its residual market-making positions under the final rule?

For business reasons or otherwise, a banking entity may determine to exit a particular line of business or trading activity that is permissible under the final rule. In the event that a banking entity terminates a market-making business that it conducted as a Volcker Rule permitted activity,¹ a situation could occur where the banking entity holds residual positions from its prior market-making activity.

In the view of the Agencies’ staffs, the banking entity may hold and dispose of these residual market-making positions, provided (i) the banking entity hedges the risks of any such positions in accordance with the risk-mitigating hedging exemption² and (ii) the banking entity sells or unwinds the residual market-making positions as soon as commercially practicable. If a banking entity holds residual market-making positions and does not

¹ See § 75.4(b).

² See § 75.5.

hedge the risks of such positions, then the subsequent sales of those residual positions would generally be considered proprietary trading under the final rule implementing section 13 of the BHC Act.³

When hedging the risks of the residual market-making positions, the banking entity must comply with the requirements of the risk-mitigating hedging exemption.⁴ A banking entity cannot rely on the market-making exemption to manage the risks of its residual market-making positions. The market-making exemption only permits risk management activity conducted or directed by a trading desk in connection with the desk's permitted market making-related activities conducted in conformance with all of the requirements of the market-making exemption set forth in the final rule.⁵

³ See § 75(b)(1).

⁴ See § 75.5.

⁵ See § 75.4(b)(2), 79 FR at 5576-5627.

Applicability of the Restrictions in Section 13(f) of the BHC Act

2. When does a banking entity become subject to the restrictions of section 13(f) and section 75.14 of the final rule with respect to a covered transaction with a covered fund? What about existing covered transactions?

Section 13(f) of the BHC Act provides that no banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund (“covered fund”), or that organizes and offers a covered fund pursuant to section 13(d)(1)(G), and no affiliate of such entity, may enter into a transaction with the fund, or with any other covered fund that is controlled by such fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c) (“covered transaction”), as if such banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.⁶ Section 75.14 of the final rule implements this statutory restriction.⁷

The statute gave banking entities a conformance period until July 21, 2014 to comply with the requirements of the Volcker Rule, and the Board extended this period by one year at the time of issuance of the final rule until July 21, 2015.⁸ As a general matter, on or after July 21, 2015, a banking entity may not enter into a covered transaction with a covered fund where the banking entity serves as investment manager, investment adviser, or sponsor to the covered fund or relies on the exemption in section 13(d)(1)(G). Staffs of the agencies believe that this restriction would apply to any increase in the amount of, extension of the maturity of, or adjustment to the interest-rate⁹ or other material term of, an existing extension of credit.¹⁰ In addition, with respect to any existing covered transaction, a banking entity should evaluate whether the transaction guarantees, assumes or otherwise insures the obligations or performance of the covered fund (or of any covered fund in which such covered fund invests) as prohibited by section 75.11(a)(5) of the final rule.¹¹

The conformance period for legacy investments in and relationships with a covered fund (i.e., investments made and relationships entered into by a banking entity prior to December 31, 2013) currently ends on July 21, 2016.¹² Staffs of the Agencies would expect a banking entity to engage in good-faith efforts during the conformance period to ensure that its investments in and relationships with legacy covered funds conform to section 75.14 of the final rule by the end of the applicable conformance period.¹³

⁶ See 12 U.S.C. 1851(f).

⁷ See 12 CFR 75.14(a).

⁸ See 12 U.S.C. 1851(c)(2); see also Board Order Approving Extension of Conformance Period (Dec. 10, 2013), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210b1.pdf>.

⁹ A floating-rate loan does not become a new covered transaction whenever the interest rate changes as a result of an increase or decrease in the index rate. If the banking entity and the borrower, however, amend the loan agreement to change the interest rate term, for example, from “LIBOR plus 100 basis points” to “LIBOR plus 150 basis points,” or from reference to the LIBOR index to the banking entity’s prime rate, the parties have engaged in a new covered transaction. See, e.g., Transactions Between Member Banks and Their Affiliates, 67 FR 76,560, 76,570 n.67.

¹⁰ This is based on the definition of “extension of credit” under the Board’s Regulation W promulgated under the Federal Reserve Act. See, e.g., 12 CFR 223.3(o)(5).

¹¹ A banking entity must be in conformance with the requirements of the final rule, including as applicable the requirements of section 13(d)(1)(G), with respect to non-legacy covered funds (i.e., a covered fund which a banking entity sponsored or invested in after December 31, 2013) following July 21, 2015.

¹² The Board granted banking entities until July 21, 2016, to conform investments in and relationships with covered funds that were in place prior to December 31, 2013, and announced its intention to act next year to grant banking entities until July 21, 2017, to conform investments in and relationships with legacy covered funds. See Board Order Approving Extension of Conformance Period under Section 13 of the Bank Holding Company Act (December 18, 2014) (hereinafter “Board’s Conformance Period Order”), available at <http://www.federalreserve.gov/newsevents/press/bcreg/20141218a.htm>.

¹³ See Board’s Conformance Period Order.