



Commodity Futures Trading Commission

Office of Public Affairs

Three Lafayette Centre

1155 21st Street, NW

Washington, DC 20581

www.cftc.gov

March 4, 2016

CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Question 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 this frequently asked question ("FAQ") applies to banking entities for which the CFTC has jurisdiction under section 13 of the BHC Act, it has been developed by staffs of the Agencies and substantively identical versions will appear on the public websites of each Agency.

Capital Treatment of Banking Entity Investments in TruPS CDOs

1. Is a banking entity required to deduct from its tier 1 capital an investment in a collateralized debt obligation backed by trust preferred securities retained pursuant to section 75.16(a) of the interim final rule ("Qualifying TruPS CDO")?

No, a banking entity is not required to deduct from its tier 1 capital an investment in a Qualifying TruPS CDO retained pursuant to section 75.16(a) of the interim final rule. Section 13 of the BHC Act generally prohibits a banking entity from acquiring or retaining any ownership interest in, or acting as a sponsor to, a hedge fund or private equity fund ("covered fund"),¹ subject to a number of exemptions. The Agencies issued final rules to implement section 13 of the BHC Act in December 2013. Shortly thereafter, in January 2014, the Agencies adopted an interim final rule to add section 75.16 to the final rules implementing section 13 of the BHC Act.² Section 75.16(a) of the interim final rule permitted banking entities to retain an interest in, or act as sponsor (including as trustee), of an issuer of collateralized debt obligations backed by trust preferred securities ("TruPS CDOs"), so long as: (i) the issuer was established, and the interest was issued, before May 19, 2010; (ii) the banking entity reasonably believes that the offering proceeds received by the issuer were invested primarily in Qualifying TruPS Collateral;³ and (iii) the banking entity's interest in the vehicle was acquired on or

¹ See 12 U.S.C. 1851(a)(1)(B); see also 17 CFR 75.10(a).

² See Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities With Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 FR 5223 (Jan. 31, 2014).

³ Under the interim final rule, a "Qualifying TruPS Collateral" is defined by reference to the standards in section 171(b)(4)(C) of the Dodd-Frank Act to mean any trust preferred security or subordinated debt instrument issued prior to May 19, 2010 by a depository institution holding company that, for any reporting period within the 12 months immediately preceding the issuance of such instrument, had total consolidated assets of less than \$15,000,000,000 or issued prior to May 19, 2010 by a mutual holding company. See 17 CFR 75.16(b).

before December 10, 2013 (or acquired in connection with a merger or acquisition of a banking entity that acquired the interest on or before December 10, 2013).⁴

Section 13(d)(4) of the BHC Act allows a banking entity to make and retain investments in a covered fund that the banking entity organizes and offers subject to certain limitations and restrictions, which are enumerated in subparagraph (B), for the purposes of: (1) establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors; or (2) making a de minimis investment.⁵ Section 13(d)(4)(B)(iii) requires that the aggregate amount of outstanding investments made by a banking entity in reliance on section 13(d)(4), including retained earnings, be deducted from the assets and tangible equity of the banking entity.⁶ Section 75.12 of the final rule implements the exemption contained in section 13(d)(4) of the BHC Act from the prohibition on investment in covered funds for de minimis investments that meet the statutory requirements and limitations, including the requirement that the banking entity deduct from the banking entity's tier 1 capital the full amount of its investment in the covered fund for purposes of calculating compliance with applicable regulatory capital requirements.⁷

These requirements in section 75.12 of the final rule do not apply to Qualifying TruPS CDOs held in accordance with section 75.16(a) of the final rules because section 75.16(a) provides an additional and independent exemption for Qualifying TruPS CDOs.⁸ If, however, a banking entity acts as a market maker with respect to interests in a Qualifying TruPS CDO that is a covered fund, then section 75.11(c) of the final rule makes the capital deduction provision in section 75.12 applicable to those interests.⁹ Moreover, if a banking entity relies on section 75.12 to hold an interest in a TruPS CDO that is a covered fund but is not a Qualifying TruPS CDO, the banking entity would be required to comply with all the limits and restrictions in section 75.12, including the requirement to deduct its investment from its tier 1 capital for purposes of determining compliance with applicable regulatory capital requirements.

⁴ See 17 CFR 75.16(a).

⁵ 12 U.S.C. 1851(d)(4)(A)(i)-(ii).

⁶ 12 U.S.C. 1851(d)(4)(B)(iii).

⁷ 17 CFR 75.12.

⁸ The preamble to the final rule explained: "As in the statute, the proposed rule applied the capital deduction to ownership interests in covered funds held as an investment by a banking entity pursuant to the provisions of section 13(d)(4) of the BHC Act, and not to ownership interests acquired under other permitted authorities, such as a risk-mitigating hedge under section 13 of the BHC Act." See 79 FR at 5730. As noted above, section 13(d)(4) permits a banking entity to make and retain an investment in a covered fund to establish the fund or to make a de minimis investment in connection with organizing and offering the fund.

⁹ See 17 CFR 75.11(c). See also 17 CFR 75.16(c) ("Notwithstanding paragraph (a)(3) of this section, a banking entity may act as a market maker with respect to the interests of an issuer described in paragraph (a) of this section in accordance with the applicable provisions of §§ 75.4 and 75.11.").