## Volcker Rule – Proprietary Trading

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<th>Prohibition</th>
<th>A banking entity (&quot;BE&quot;) may not engage in proprietary trading.</th>
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| Status      | Statutory effective date: July 21, 2012.  
Conformance: by statute, July 21, 2014, extended to July 21, 2015, with two one-year extensions possible on application.  
Regulation: Final Rule adopted December 10, 2013 (effective April 1, 2014). |
| Key Definitions | **Proprietary trading:** “Engaging as principal” for its own “trading account” … in a “purchase or sale of one or more financial instruments.” |

### BE:
- Insured depository institutions and companies that control insured depository institutions.
- Foreign banks that maintain a U.S. branch or agency or control a U.S. commercial lending company and any foreign company that controls such foreign bank.
- Any affiliates or subsidiaries of the above.

### Trading account: Account that satisfies any of three criteria: purpose test; market risk capital rule test; or status test. The purpose test addresses trading for short-term resale (presumed if held for fewer than 60 days or for benefitting from short-term price movements. The market risk capital test is for a U.S. bank or thrift or a U.S. bank or thrift holding company that is subject to the U.S. banking agencies’ market risk capital rules; for such banking entities, a trading account includes an account used to trade in financial instruments that are both market risk capital rule covered positions and trading positions. The status test addresses, for a BE that is a securities dealer, swap dealer or securities-based swap dealer, trades that would require them to be licensed as such; such trades are deemed to be in a trading account.

### TRADING EXCLUDED FROM PROPRIETARY TRADING
- Repo/reverse repo
- Securities lending
- Liquidity management pursuant to a plan
- DCO and clearing trades

### PERMITTED PRINCIPAL TRades
- U.S. government/agency securities
- U.S. munis
- By a foreign subsidiary of a U.S. BE of debt of foreign government in the country in which the subsidiary is organized
- On a customer’s behalf as a fiduciary or riskless principal
- By a BE that is a regulated insurance company

### Trades
- to satisfy an existing obligation
- to satisfy a court order
- where BE is acting solely as agent, broker, custodian
- through a deferred compensation plan
- in course of collecting previously contracted debt
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<th>Requirements:</th>
<th>Potential Concerns for Trading Outside the U.S. by a Foreign BE</th>
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<tr>
<td>• Foreign BE not controlled by U.S. BE;</td>
<td>• No trades with U.S. counterparties except:</td>
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<tr>
<td>• Trade conducted by QFBO under Reg. K or by other foreign BE whose non-U.S. business exceeds its U.S. business</td>
<td>• - with non-U.S. operations of U.S. BE; or</td>
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<tr>
<td>• Foreign BE (including personnel who negotiate and execute trades) must be outside U.S.</td>
<td>• - if promptly cleared and settled through a clearing agency or entity acting as a central counterparty:</td>
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<tr>
<td>• Trades must be booked outside U.S.</td>
<td>• - with an unaffiliated U.S. intermediary acting as a principal; or</td>
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<tr>
<td>• No trades may be financed from U.S.</td>
<td>• - with an unaffiliated U.S. intermediary acting as agent if conducted anonymously</td>
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<th>Other Exemptions Subject to Satisfaction of Certain Conditions*</th>
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<th>Risk-mitigating Hedging Activities</th>
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<td>Covers “individual or aggregated positions, contracts, or other holdings” and “designed to reduce the specific risks” related to such positions</td>
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<th>Certain Market making Activities</th>
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<tr>
<td>May not exceed “reasonably expected near term demands” of clients, customers, or counterparties</td>
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<td>Trading desk underwriting position must be related to a distribution for which bank is an underwriter</td>
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<th>Underwriting Activities</th>
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<td>Three overall conditions for these permitted activities:</td>
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<td>• BE must maintain an internal compliance program</td>
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<td>• Compensation arrangements of personnel involved in activities cannot be designed to reward proprietary trading</td>
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<td>• BE must be appropriately authorized to conduct permitted activity</td>
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<th>PRUDENTIAL BACKSTOP</th>
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<td>Proprietary trading activities not permissible if they:</td>
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<tr>
<td>• involve or result in a material conflict of interest between the BE and its clients, customers or counterparties</td>
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<tr>
<td>• would result in a material exposure by the BE to a high-risk asset or a high-risk trading strategy</td>
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<tr>
<td>• pose a safety and soundness threat to the institution or a threat to U.S. financial stability</td>
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### Prohibition

A BE, as principal, directly or indirectly, may not acquire or retain any ownership interest in, or sponsor, a covered fund.

### Key Definitions

**Sponsorship means:**
- to serve as GP, managing member, trust or CPO of a covered fund
- to control or select majority of directors, trustees or management of a covered fund
- to share with covered fund the same name or a variation thereof

**Ownership interest means:**
- any equity, partnership or other similar interest
- similar interest may include: right to participate/select GP or manager; right to receive a residual economic interest
- does not include a carried interest

**Covered fund:**
- Issuer that avoids mutual fund registration under Sections 3(c)(1) or 3(c)(7) of Investment Company Act because securities are offered privately and are owned either (i) by 100 persons or fewer or (ii) by “qualified purchasers”
- Commodity pool for qualified investors
- For BE that is, or is controlled by a U.S. BE, fund organized or offered outside U.S. sponsored by a U.S. BE that would be covered by either of the two definitions above, if organized or offered under U.S. law

**Effect of definition on non-U.S. funds:**
- Foreign fund not offered or sold to U.S. Persons that is sponsored by a foreign BE, or in which a foreign BE invests, is not a covered fund, if the foreign BE is not controlled by a U.S. BE
- However, if such foreign fund is not a covered fund, it may be a BE if controlled by foreign BE

### ENTITIES THAT ARE NOT COVERED FUNDS

- Not an investment company
- Not reliant on Section 3(c)(1) or 3(c)(7)
- A foreign public fund
- Qualifying covered bonds issued or guaranteed by a foreign BE
- Foreign pension or retirement funds
- Insurance company separate accounts
- SBICs
- A loan securitization vehicle
- Wholly owned subs
- JVs, acquisition vehicles
- Registered investment companies
- BOLI separate accounts
- FDIC vehicles used in receivership

### Permissible Fund Activity Outside the U.S. by Foreign BE

**Requirements:**
- Fund interests may be offered and sold only in an offering that does not target U.S. Persons (e.g., Reg. S compliant)
- Conspicuous disclosure of offering restrictions
- Foreign BE cannot be controlled by a U.S. BE or organized in U.S.
- Foreign BE that sponsors or invests in the foreign fund must by a QFBO

**Potential Concerns**

Even when exemption applies:
- Prudential backstops apply
- Super 23A and 23B apply (see below)
- Compliance program required
under Reg. K or other foreign BE whose non-U.S. business exceeds its U.S. business
- Investment/sponsorship must be booked outside the U.S.
- Foreign BE must make investment/sponsorship decisions outside the U.S.
  - Back office and administrative functions can be in U.S.
  - Investment advice to the fund can be given from U.S. (but investment decisions must be made outside the U.S.)
- No U.S. affiliate of foreign BE can finance any fund investment

### OTHER PERMITTED FUND ACTIVITIES
- Customer fund activity
- Ownership of entities issuing asset-backed securities where BE organizes and offers the entity’s interests
- Underwriting and market making of covered fund interests

#### Super 23A and 23B
- Neither a BE nor its affiliate may extend credit to, or purchase assets from, a covered fund that it advises or sponsors
- The “market terms” requirements of Section 23B of the Federal Reserve Act apply as if the BE were a bank and the fund it sponsors/advises, its affiliate

### INVESTMENT LIMITS
- Per-fund limit of 3% of value of, or number of ownership interests in, covered fund
- Aggregate limit of 3% of BE’s Tier 1 capital

### PRUDENTIAL BACKSTOP
No permitted fund activities or investments are permissible if the activity/investment:
- involves or results in a material conflict of interest with clients, customers or counterparties
- results in a material exposure by the BE to a high-risk asset or high-risk trading strategy
- poses a safety or soundness threat to the institution or a threat to U.S. financial stability